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GIS

S. HRG. 100-9

PROPOSED FISCAL YEAR 1988 BUDGET REQUEST
(FERC and Forest Service)

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

ONE-HUNDREDTH CONGRESS

FIRST SESSION

TO REVIEW THE PRESIDENT'S PROPOSED BUDGET FOR FISCAL YEAR 1988 IN CONNECTION WITH THE PREPARATION OF THE FEBRUARY 25 REPORT TO THE SENATE BUDGET COMMITTEE

FEBRUARY 17, 1987

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE

71-520 WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S311-35

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CONTENTS

STATEMENTS

	Page
Bingaman, Hon. Jeff, a U.S. Senator from the State of New Mexico	17, 161
Domenici, Hon. Pete V., a U.S. Senator from the State of New Mexico	27
Dunlop, Hon. George S., Assistant Secretary for Natural Resources and Environment, Department of Agriculture; accompanied by F. Dale Robertson, Chief, Forest Service; and George Leonard, Associate Chief, Forest Service	126
Ford, Hon. Wendell H., a U.S. Senator from the State of Kentucky	32
Hatfield, Hon. Mark O., a U.S. Senator from the State of Oregon	22, 154
Hesse, Hon. Martha O., Chairman, Federal Energy Regulatory Commission	1
Johnston, Hon. J. Bennett, a U.S. Senator from the State of Louisiana	1
McClure, Hon. James A., a U.S. Senator from the State of Idaho	22
Nickles, Hon. Don, a U.S. Senator from the State of Oklahoma	27
Robertson, Hon. F. Dale, Chief, Forest Service, Department of Agriculture	142
Weicker, Hon. Lowell P. Jr., a U.S. Senator from the State of Connecticut	20

APPENDIXES

APPENDIX I

Responses to additional committee questions from the Federal Energy Regulatory Commission 193

APPENDIX II

Responses to additional committee questions from the Department of Agriculture, Forest Service 234

PROPOSED FISCAL YEAR 1988 BUDGET REQUEST

(FERC and Forest Service)

TUESDAY, FEBRUARY 17, 1987

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The Committee met, pursuant to notice, at 9:33 a.m., in room SD-366, Dirksen Senate Office Building, Hon. J. Bennett Johnston, chairman, presiding.

OPENING STATEMENT OF HON. J. BENNETT JOHNSTON, A U.S. SENATOR FROM THE STATE OF LOUISIANA

The CHAIRMAN. The hearing will come to order.

This morning we hear from the Federal Energy Regulatory Commission; from the Assistant Secretary for Natural Resources and Environment of the U.S. Department of Agriculture; and from the Forest Service, which is also of course a part of the Department of Agriculture.

I am very pleased to welcome, first of all, the outstanding Chairman of the Federal Energy Regulatory Commission who is always very welcome in this Committee, Martha Hesse.

STATEMENT OF HON. MARTHA O. HESSE, CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION

Ms. HESSE. Thank you.

Mr. Chairman and members of the Committee, it is good to be here with you this morning. It was only a few short months ago that I appeared before this Committee at my confirmation hearing. It seems actually a lot longer time ago than it has been.

I am here today to present to the Committee the proposed fiscal year 1988 budget for the Federal Energy Regulatory Commission. Our proposed budget of $104 million will fully support FERC program operations. Salaries and personnel costs represent 70 percent of this.

Mr. Chairman, I have a prepared statement that I would like to ask to be included in the record of this hearing.

The CHAIRMAN. Without objection.

Ms. HESSE. During the past 4 months, we at the Commission have moved forward in a number of areas. America's natural gas industry is in a state of evolution, adapting to a more competitive environment. As the Commission prepares for the future, we must

resolve a number of important regulatory issues: how to deal with take-or-pay costs which have been incurred; how to design rates to avoid future take-or-pay problems and to effectively allocate gas and gas services; how to promote fair market practices; how to revamp our abandonment procedures; and how to improve the efficiency of data collection through the establishment of automated systems.

Last month I announced a strategy for 1987 designed to resolve these difficult issues. Our goal is to move forward within our statutory authority to allow the demand for gas and gas delivery services to establish the price for gas and those services.

I have worked closely with my fellow Commissioners and I am pleased to say that each is in general agreement with both the aims of the strategy and the policy objectives. In addition, I am pleased to report to you that over the past four months the Commission has made excellent progress in implementing Order 436, Open-Access Transportation; and Order 451, Regulating the Price of Gas.

Since October 1, we have considered and approved 6 of the 13 major pipeline Order 436 settlements. In addition, tariff and rate filings have been approved permitting 17 of the 20 major interstate pipelines to provide interim open access transportation, even while they are completing negotiations with their customers on permanent settlements.

On December 15, the Commission issued its rehearing order on Order 451; and on January 23 of this year, it took effect without any court stay.

The final rule contains several provisions designed to protect consumers and assure that wellhead gas prices are market responsive. Our review of initial purchased gas adjustment filings made by pipelines under Order 451 indicates that most major pipelines and producers may be using the rulemaking as a framework for voluntary renegotiation of old gas prices.

As a result, consumer gas prices are remaining stable or even falling at the city gate.

Like the gas industry, America's electric utility industry is in a state of transition. Important structural issues may require innovative policy and decisionmaking over the next several years. These include the role of co-generation and providing electric supply incentives for development of long-term capacity, and how to avoid the necessity for after-the-fact prudence reviews.

These issues, as well as whether there should be greater pricing flexibility, should be looked at in the context of an overall electric policy strategy.

Last year's enactment of the Electric Consumers' Protection Act meant important changes in the Commission's hydroelectric program, and I am pleased to report that we have made important progress implementing this new law.

We have initiated the required study of whether incentives under PURPA should be extended to hydro facilities using new dams or diversion structures. The Commission has issued the required rule addressing which projects wishing to benefit from PURPA will be exempted from certain aspects of the new law.

We seek an orderly transition from yesterday's criteria to today's as a result ECPA without harming those applicants who have committed substantial sums of money to a project only to find that the rules of the game have been changed midstream.

We are also well down the road toward completing a final rule addressing what information existing licensees must make available when notifying the Commission about their intention to seek a new license.

In addition to these areas that I have mentioned, a number of management reforms are now being implemented at the Commission. Some are the result of a study to examine our case processing that I commissioned my first day on the job. The Commission's job is to decide cases within the confines of laws enacted by Congress as defined by the courts, and I believe we are making progress in deciding many of the cases that have been backlogged at FERC.

We are making progress, but much remains to be done and we are working hard to do it.

Thank you, and I will be glad to answer your questions.

[The prepared statement of Ms. Hesse follows:]

STATEMENT OF

CHAIRMAN MARTHA O. HESSE

FEDERAL ENERGY REGULATORY COMMISSION

FY 1988 BUDGET OVERSIGHT HEARINGS

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

FEBRUARY 17, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I appreciate the opportunity to appear before you to present the FY 1988 budget request for the Federal Energy Regulatory Commission (FERC).

BUDGET OVERVIEW

Our request for FY 1988 is $104 million. This is about $5 million more than we have to operate with this year, but the net cost to the Treasury and to the taxpayer will be zero. We have recovered a substantial portion of our budget in the past by collecting filing fees from applicants and assessing annual charges on hydropower licensees. New authority approved by Congress in the Omnibus Budget Reconciliation Act of 1986, will now allow us to recover our entire budget through annual charges and fees. We are moving ahead rapidly with the necessary rulemakings to implement this legislation within the next few months, and we plan to have procedures in place to start the full cost recovery program this fiscal year.

PROGRAM OPERATIONS

This proposed budget will fully support FERC program operations. It is important to emphasize that FERC is a labor-intensive agency, and our budget request is for carrying out the regulatory mandates prescribed in statutes, as interpreted by the courts.

Salaries are 70 percent of our budget. Moreover, personnel costs will take a big jump in FY 1988 due to the implementation of the Federal Employment Retirement System (FERS) and the Government-wide 3 percent pay raise for the federal workforce. Together these represent a $6.5 million increase in personnel costs. While the Commission can absorb close to 40 percent of those costs or $2.4 million, we do require an increase in our budget for the balance.

Fixed costs such as rent, telephone, and computer support account for another 17 percent of our request. Other non-discretionary costs include such items as environmental studies in the hydropower program, travel for auditors, and dam safety inspectors.

MANAGEMENT APPROACH

As important as it is to reduce these costs--the ones for which we request funds from you--there are other costs I am seeking to reduce. They do not show up in the budget tables, but they are very important.

These "costs" equate to time--the time it takes for an applicant to prepare a filing as prescribed by our rules, and the time the FERC takes to render a decision--the real cost of regulation.

On my first day as Chairman, I initiated a study to examine casework processing at the FERC. My objective is to improve processing times so as to reduce both the FERC costs and the cost

to the applicants. We have already begun management reforms as a result of this effort:

- FERC staff will now make greater use of its delegated authority;
- We are moving to make further use of generic approaches to decision-making where possible. Case-by-case workload processing is expensive in both FERC staff time and in the time an applicant waits for a decision;
- The management information system was not geared to management requirements. We have simplified it and will save over $100,000 a year; and
- We will coordinate the management information system with installation of a new office automation system.

Our budget request includes funds for an office automation system. Our goal is to:

- reduce the time required to prepare correspondence and Commission orders;
- eliminate delays caused by physically transporting hard copy information as work products move through the process;
- provide technical staff with analytical tools to assist them in processing applications; and
- provide technical access to management, energy data, and legal research systems.

The objective of these initiatives is to improve FERC's efficiency in its decision-making process.

The FERC has a substantial impact on the energy community. Every docket and filing that comes before the Commission involves monetary decisions. That places a heavy obligation on FERC to appreciate the time value of money and make decisions in a timely manner.

COMPETITION AND REGULATION

In private business, and now as a regulator, I have seen the benefits of competition. Competition has served our nation well--providing the backbone of our economy and benefiting those average citizens for whom we work and whose interests we seek to protect. Regulatory policies should strive to achieve those outcomes that would emerge in a truly competitive market. Competition, where it exists, is the most effective force available for encouraging efficiency.

Whenever possible, regulations should be used to assure that markets are responsive to competition. When this is not possible, they should work to simulate an environment that will produce the same result as if there had been a truly competitive market.

NATURAL GAS PROGRAM

Our Natural Gas Program is an example of how competition can be the best regulator.

The Commission must implement its major natural gas reforms, Order Nos. 436 and 451, predictably and consistently to permit

all segments of the industry to respond on a timely basis to the new competitive pressures and restructuring occurring in natural gas markets.

As we prepare for the future, and the changing markets, there are a number of very important regulatory issues that remain to be resolved:

- How to deal with take-or-pay costs which have been incurred;
- How to design rates to avoid future take-or-pay problems and to allocate gas and services;
- How to promote fair market practices;
- How to revamp abandonment procedures;
- How to improve the efficiency of data collection through the establishment of automated systems.

Last month I announced a strategy for 1987 for resolving these issues. Our goal is to move forward within our statutory authority to allow the demand for gas and gas delivery services to establish the price for gas and those services.

I have worked closely with my fellow Commissioners, and am pleased to report that each is in general agreement with both the aims of the strategy and the policy objectives.

In fact, the Commission will be discussing what policy is appropriate for dealing with take-or-pay costs. This issue has been under very active consideration by the staff and the Commission and will be discussed tomorrow at the Commission meeting.

In addition, I am pleased to report to you that in my first few months on the job, the Commission has made excellent progress in implementing Order No. 436 and Order No. 451.

Since October 1, 1986, the Commission has considered and voted to approve 6 of the 13 major interstate pipeline Order No. 436 settlements pending before it. Of the remaining seven pipelines, two are already transporting under interim Order No. 436 settlements approved by the Commission, one is scheduled for Commission action tomorrow, three will be considered by the Commission by the end of April, and one has written the Commission indicating that its pending settlement may be superseded by a new settlement offer.

In addition, the Commission has approved tariff and rate filings that permit 17 of 20 major interstate pipelines to provide interim open access transportation service under Order No. 436 even while they are completing negotiations with their customers on permanent settlements.

As Chairman, my goal in implementing Order No. 436 is to assure that the Commission's review is responsive to the needs of the public for long-term, reliable access to gas services at reasonable cost.

I am also pleased that, on December 15, 1986, the Commission's rehearing order on Order No. 451 was issued by unanimous vote. On January 23, 1987, Order No, 451 took effect without any court stay. The Commission concluded that Order No. 451 is unlikely to cause any unreasonable price impacts on natural gas consumers during its phased implementation. This is because the final rule includes several key provisions designed to protect consumers and to assure that wellhead gas prices are market-responsive.

The Commission's review of initial purchased gas adjustment filings made by pipelines under Order No. 451 indicates that most major pipelines and producers may be using the rulemaking as a framework for voluntary renegotiation of old gas prices. As a result, consumer gas prices are remaining stable or even falling at the city-gate. The Commission will continue to monitor closely the early implementation of Order No. 451 over the next several months.

Needless to say, I will keep the members of this Committee fully informed on our progress in this effort to adapt natural gas regulatory policies to the increasingly competitive gas market place.

ELECTRIC POWER PROGRAM

The electric utility industry clearly is in a state of transition. There are several important structural issues which may require innovative policy and decision making by the Commission over the next several years. Among these are: the role of cogeneration in providing electricity supply; providing

up-front incentives for developing reliable long-term capacity and avoiding the necessity for after-the-fact prudence reviews of decisions to build power plants.

On the question of cogeneration, I announced on January 7, 1987, a series of regional public conferences to look at the growing concerns about cogeneration of electric power and small power production by independent power producers. There are many questions concerning cogeneration, such as operating and efficiency standards, avoided cost rates for purchases of power, and ownership limitations. These conferences will provide a forum in which persons affected by cogeneration can air their views, and will help us to assess how effectively the current program is operating.

On the question of prudence reviews, it is important to note that they are, at present, backward looking. Our responsibility must be to prevent imprudent costs -- rather than decide who is to pay for them later.

These issues, as well as whether there should be greater pricing flexibility, should be looked at in the context of developing an overall electric policy strategy. I believe the Commission must be prepared to follow a path which leads toward an efficient, competitive industry well-positioned to meet the energy demands of the future--a future where enlightened regulatory policies will allow competition to develop and all segments of the industry to flourish.

HYDROPOWER PROGRAM

Major initiatives have occurred in the Commission's hydropower program as a result of the passage of the Electric Consumers Protection Act of 1986 (ECPA).

The Commission has already issued one of the rules required by this statute. This rule addresses which projects wishing to benefit from the Public Utilities Regulatory Policies Act (PURPA) will be exempted from certain new environmental standards based on the applicant's commitment of substantial monetary resources.

Our goal is to provide an orderly transition from yesterday's criteria to today's without harming those applicants who have committed substantial sums of money to a project only to find that the rules of the game have been changed midstream.

We are also well down the road toward completing a rule dealing with the information that existing licensees must make available when notifying the Commission about their intention to file an application for a new license.

The Commission has also initiated the study required by ECPA on whether PURPA incentives should continue to be extended to hydro facilities using new dams or diversion structures.

In addition, I am pleased to report that the Commission's trial implementation of the Cluster Impact Assessment Procedure on three river basins is nearing completion. This procedure has provided the Commission with valuable and useful

experience. However, I am concerned about the amount of time that this proce dure has taken. I have asked the staff to review our experience with this procedure and to determine if there is a more efficient and effective approach, consistent with the National Environmental Policy Act, to deal with the environmental issues facing the Commission's hydropower program. This review is underway and will be completed in the very near future.

OIL PIPELINE REGULATION

In the area of Oil Pipeline Regulation, the Commission has implemented its new ratemaking methodology established in Opinion No. 154-B, with the first 2 formal cases expected to be before the Commission for resolution in February 1988. This new methodology requires review. Workload in formal rate cases should continue at approximately the same level as in fiscal year 1987. In addition, the Commission must commit resources to review pricing cases which are referred to FERC by DOE.

SUMMARY

In the past 4 months, the Commission has begun a new approach in the process of reviewing and rethinking its role in promoting the public interest for consumers, investors, and the economy at large. Challenging, yet timely, questions have been raised, and the Commission is developing a comprehensive approach addressing key energy issues. Embodied in this initiative is the notion that competition is the most effective force available for encouraging efficiency.

These areas of innovation will require not only policy decisions by the Commission but strong leadership and management to assure that the decision-making process itself is fully responsive to the needs of the public, the industry and Congress. This budget request contains the minimum resources that will allow the Commission to encourage the competition and efficiency necessary to benefit consumers while avoiding a recurrence of the energy shortages of the 1970s.

Thank you very much for this opportunity to report to you on the FERC's progress in meeting the challenges of a rapidly changing energy environment.

I will be happy to answer any questions you may have.

The CHAIRMAN. Thank you very much, Ms. Hesse.

In a word, the FERC budget is straightforward. You take last year's budget, make no program changes, adjust for the pay raise, and other than that it is pretty well exactly at last year's, is it not?

Ms. HESSE. Exactly, on a straight line.

The CHAIRMAN. Now, Ms. Hesse, can you tell me the status of implementation of the hydro relicensing legislation?

Ms. HESSE. I can. We have put together a task force. It was put together actually on one of my first days at the Commission. It is composed of senior people to review the law and its requirements, and specifically what the Commission must do.

We have put forth a number of new rulemakings as required by law. There is another one that will be was required within the next several weeks, and we will do that. I think that we are on track, as Congress intended, in the implementation of ECPA.

We have had a number of discussions with the heads of other Federal agencies. For example, Bill Horne and I have had discussions on ECPA, and we have decided that the best way for us to proceed is to develop a memorandum of understanding, and then–as opposed to having the staff develop it and having it come up–we will develop it and have it go down.

I intend to also meet with other heads of other Federal agencies who are involved in ECPA so that we can make certain that there are not delays based on misunderstandings between and among the staff.

The CHAIRMAN. Ms. Hesse, I want to congratulate you on your efforts to resolve perhaps the most vexing and difficult problem facing the natural gas industry, and of course that is the issue of take-or-pay.

Could you outline briefly your proposal for the Committee?

Ms. HESSE. Mr. Chairman, I submitted to my colleagues at the end of January an outline of a proposed solution to the take-or-pay problem. We are discussing that at tomorrow's meeting. There is not a published, or a noticed document for discussion. I need not explain to you the fragility of collegiality, but I would prefer not to talk about the specifics of the take-or-pay proposal until after my colleagues have had an opportunity to discuss it in an open meeting.

I would be pleased to come back tomorrow, or Thursday, or any day, any day after we have had an opportunity to discuss it as a Commission. I will say that I think that it does follow my interest in spreading the pain evenly. There are many parties who are responsible for take-or-pay, and I think that each of these individuals, each of these parties needs to step up and be counted and assume part of the responsibility.

I am not trying to sidestep, but I guess I am.

The CHAIRMAN. I perfectly well understand that and appreciate it, and do not disagree with that. I would encourage you to base take-or-pay, your proposals, on two things.

First, as I believe you indicated, the past liabilities should be fairly apportioned among all customers and not just some customers, and I understand you are being urged to do the latter by some people; and from my standpoint, it ought to be equitably distributed among all customers.

Secondly, it ought to be put together so that in the future pipelines will be able to purchase adequate supplies. As we all are painfully aware, exploration and development in the gas industry is falling rapidly, I think alarmingly, and I think that the so-called "gas bubble" is probably going to be gone maybe by next year and spot shortages are going to begin to appear soon, and we are not going to have the supplies to take that place. So our policy should recognize the need to encourage exploration.

Do you have sufficient resources with this budget to do the job?

Ms. HESSE. I believe that we do, yes.

The CHAIRMAN. Senator Bingaman?

STATEMENT OF HON. JEFF BINGAMAN, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator BINGAMAN. Thank you, Mr. Chairman.

Ms. Hesse, let me ask about this Canadian gas problem that people in my State are particularly interested in.

The Commission issued a decision in December which as I understand it prohibits differential treatment in rate designs with regard to allocating costs. Could you give me an explanation of that decision, the justification for it? It is a decision that is wholeheartedly supported by many of the gas producers in my State. They feel that without such a decision they have been put at a competitive disadvantage with regard to gas coming in from Canada. Maybe you could explain it?

Ms. HESSE. Well, Senator, the Commission believes in free trade, but it also believes in fair and equal trade. What we did in that decision was to determine how U.S. pipelines bill U.S. customers. We said that there would not be, there could not be any differences between domestic and imported gas in the way it is billed to U.S. customers.

This does represent a change from the past.

Senator BINGAMAN. What is the status of that decision at this point? Is it a final decision? Do you expect a final decision in the near future?

Ms. HESSE. Rehearing is pending. So I would presume that at some time in the next several months that it will appear before the Commission for a final decision.

Senator BINGAMAN. And would it be your expectation to apply that same decision to other pipelines bringing Canadian imports into the country?

Ms. HESSE. That is correct.

Senator BINGAMAN. Well, I want to just inform you and go on record here indicating my support for what you are doing. I do think it is correcting an inequity that has existed for some time. I realize the Canadian Government is not happy with this change in procedure, but I think it is something that is necessary to preserve our domestic production.

Ms. HESSE. Thank you, Senator.

Senator BINGAMAN. That is all I had, Mr. Chairman.

[The prepared statement of Senator Bingaman follows:]

STATEMENT BY SENATOR JEFF BINGAMAN
OVERSIGHT HEARINGS ON THE FERC BUDGET
February 17, 1987

I thank the Chairman for scheduling this oversight hearing to review the proposed fiscal year 1988 budget for the Federal Energy Regulatory Commission. I want to make some general comments about current FERC activities.

Chairman Hesse has moved quickly in her first few months to develop a comprehensive natural gas regulatory strategy. This strategy is designed to deal with the particularly difficult issues of contract carriage, take or pay, and old gas vintaging. I may not agree completely with her ideas, but I applaud her for attempting to move forward.

I am pleased to see a recognition by the Chairman of the need for improving the casework management system. I hope her efforts can result in increased efficiency at the agency.

I have a particular interest in a recent decision by the FERC to disallow differential treatment in rate designs.

This decision has been very popular with producers from my state who feel it will help United States gas sell on a more competitive basis vis a vis Canadian gas.

I look forward to discussing this and other issues with you.

The CHAIRMAN. Senator McClure.

Senator MCCLURE. Let me yield to those who were here earlier.

The CHAIRMAN. Fine. Senator Weicker?

STATEMENT OF HON. LOWELL P. WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT

Senator WEICKER. Thank you very much, Mr. Chairman.

I have a statement, which I do want to express, and then I have a couple of questions I want to ask the Chairman.

I have no questions relative to the proposed budget, but I would like to take this opportunity to discuss with you, Madam Chairman, the various aspects of the Commission's recently issued Order 436.

As you are aware, Connecticut's most controversial energy issue today is a proposed construction by the Iroquois Gas Transmission System of a 356-mile natural gas pipeline from Canada through the State's most scenic and unspoiled land. What has exacerbated the matter is the pipeline's application under the optional expedited certificate procedures within Order 436.

The people of Connecticut are distressed that their concerns may well be overlooked in expedited consideration, and little has changed to alleviate those worries. I wrote to the Commission in August of last year urging the use of the more thorough and conventional procedure of section 7(c) of the Natural Gas Act for consideration of such a large pipeline project.

In hearings last year in which you appeared before this Commission, I was given assurances by you that every effort would be made not to overlook the very serious issues that arose from an application with a potential for such large environment impacts.

In reviewing the entire matter, it is clear that the use of expedited procedures in considering the Iroquois pipeline is not the only controversial issue regarding Order 436. Presently the D.C. Court of Appeals is reviewing the question of whether the Order would seriously disrupt markets by allowing gas suppliers to service large customers directly, thus bypassing distributors and retail marketers of natural gas.

The optional expedited certificate procedure is a central question in the case, and FERC has even stated to the court the need to rule at least in part on the expedited procedures now rather than postponing to a later lawsuit, considering the recent issuance of Order 436, the fact that no expedited certificate has yet to be granted, and the court's view which may significantly alter the structure and implementation of Order 436 if opposed to FERC's consideration of certificate applications under Order 436's expedited procedures pending the resolution of these very serious questions.

I think that it is clear now that the entire, not just the northwestern corner of Connecticut, but indeed the State Government itself as expressed by the Governor, is against this matter. I would like to first of all just get your observations as to where things stand, but I cannot think of one issue that has so united the entire State as this. If anything, I would say that the feelings run more strongly now than they did when you were kind enough to appear in Torrington, Connecticut, this past summer.

So before any specific questions, I wonder if you would generally comment as to where the matter now stands.

Ms. HESSE. Well, the Iroquois application is at present on a two-track process. The first track is the environmental assessment. Perhaps an optional expedited procedure was misnamed because the environment concerns and environmental assessment must go on regardless of anything else, and that of course takes time.

The comment period for the environmental impact statement does not close until later this month. The draft environmental impact statement will probably be finished sometime in late summer or early fall. At that point, it will take at least another 90 days for public comment. We are considering holding local hearings in Connecticut to afford the citizens the opportunity to comment on the draft environmental impact statement. That is that track.

In addition to that, the Commission recently set out new guidelines for the optional procedure in the Erie-Transylvania case, and those guidelines clearly stated that the pipeline must be willing to assume the full risk of the project. The Iroquois organizers have refiled their application based on the new guidelines, and we are about to notice that for public comment.

That is the status.

Senator WEICKER. At this time, the various organizations and persons in Connecticut have no indication of what the Commission will do in using the expedited procedures. When will the Commission act on the numerous requests for a hearing on the application?

Ms. HESSE. Well, until the environmental impact statement is finished and presented to the Commission, the Commission will not formally consider anything concerning the Iroquois application.

Senator WEICKER. Now I gathered from your remarks that you are considering now also having public hearings on that environmental statement. Is that correct?

Ms. HESSE. Yes, Senator.

Senator WEICKER. Could I possibly urge you and get a commitment from you to actually have those hearings?

Ms. HESSE. We will have the hearings.

Senator WEICKER. Is it possible to have those hearings?

Ms. HESSE. Yes.

Senator WEICKER. I think that is important, I think, in any of these matters. I understand the constitutional role that you have to play in this matter, and for that reason it is not something that can just be dismissed offhand. I would like to do that, quite frankly, but that is not in the cards. But it certainly would give me greater assurances if we would have those hearings which you are now considering, and you indicated to me that we will have those hearings.

Ms. HESSE. I will commit to holding those hearings.

Senator WEICKER. I appreciate that.

I have no further questions. I yield at this time. I will have further questions later on.

The CHAIRMAN. Senator Hatfield, did you have any questions?

STATEMENT OF HON. MARK O. HATFIELD, A U.S. SENATOR FROM THE STATE OF OREGON

Senator HATFIELD. Thank you, Mr. Chairman.

I have one comment, Madam Chairman. On page 3 of your testimony you indicate that part of your requests in the budget relate to an office automation system. I would only indicate to you that if there is any way that we can be helpful on that, we certainly would be pleased to do so.

We have had everyone from the White House to the Navy Department review our automation. We have instituted sort of the pioneering of it here on the Hill, and we would certainly be very happy to make our experience available to you on that matter. I want to commend you on making this step, because I think too often both the Hill offices, more especially a disaster of administration of offices on the Hill is only to be viewed visually by walking down the Hart Building and looking through the glass windows and seeing the utter chaos that exists in most of the offices vis-a-vis stacks of paper, probably unanswered mail, and a few other things.

So having I think done pretty well in conquering this problem, I want to commend the agency that you represent for taking this step, because I think a lot of the problems between the Hill and the agencies are precisely on this point of unanswered correspondence and delayed correspondence. So I want to commend you for taking this step, and if we can be helpful we would be happy to do so.

Ms. HESSE. Thank you, Senator.

Senator HATFIELD. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Melcher?

Senator MELCHER. No questions, Mr. Chairman.

The CHAIRMAN. Senator Domenici. Excuse me. Senator McClure.

STATEMENT OF HON. JAMES A. McCLURE, A U.S. SENATOR FROM THE STATE OF IDAHO

Senator MCCLURE. I just have a couple of questions. I may submit others for the record.

First I want to thank you for the action the Commission took with respect to a temporary interim order for the Northwest Pipeline. My understanding is that that order expires on May 1. Am I correct?

Ms. HESSE. That is correct.

Senator MCCLURE. Will you be in a position to issue the final order by that time, or are we going to run into another interim position?

Ms. HESSE. Well, we certainly are committed to doing everything that we can to make certain that we do not run into another interim settlement. We are in the process of reviewing the final settlement that has been submitted to the Commission and will make every effort to consider that certainly by early April.

Senator MCCLURE. Well, I would hope, first, that you could get the final order made. Obviously you want to do that. I think all parties would be best served by getting the final solution in place, whatever that may be. But secondly, in the event that should not happen, I would hope that we would be able to continue the inter-

im measure until the final order is ready, until you are ready to issue the final order. Is that a possibility?

Ms. HESSE. Well, certainly that is a possibility. I do not think that, based on all our schedules, that that is going to be necessary. I mean, we are very interested in making certain that we do finish this in the time allotted.

Senator MCCLURE. Well, I will not belabor it if indeed it is a moot question. If you get the final order out, then we do not have to discuss the other.

I want to commend you and the Commission for I think a very real effort to try to shorten that backlog.

Ms. HESSE. Thank you.

Senator MCCLURE. I think you are committed to that. I know you are, and I know that this Committee is, because a regulatory scheme to work has to work; it has got to be able to function and get decisions made in a reasonable length of time. That has not always been the case with FERC. I hope that you are gaining on us. Can you tell us you are?

Ms. HESSE. I can. We are committed to decreasing the backlog, and the staff is working very hard. People work evenings, and weekends, and holidays, and I am very grateful to them for that. I think that they want to see the backlog decrease, as well.

Senator MCCLURE. Thank you very much, Mr. Chairman. I will have some other questions for the record.

[The prepared statement of Senator McClure follows:]

OPENING STATEMENT
SENATOR JAMES A. McCLURE (R-ID)
COMMITTEE ON ENERGY AND NATURAL RESOURCES
TUESDAY, FEBRUARY 17, 1987

HEARING ON PROPOSED FISCAL YEAR 1988 BUDGETS FOR THE FEDERAL ENERGY REGULATORY COMMISSION AND THE FOREST SERVICE

MR. CHAIRMAN, I WOULD LIKE TO MAKE A BRIEF STATEMENT BEFORE WE HEAR FROM CHAIRMAN MARTHA HESSE, AND REPRESENTATIVES OF THE FOREST SERVICE.

AS I OBSERVED EARLIER, I AM ENCOURAGED THAT THE ADMINISTRATION'S PROPOSED BUDGET FOR FISCAL YEAR 1988, ON ITS SURFACE, APPROXIMATES 1987 APPROPRIATIONS. IN THE AGGREGATE, I CAN SUPPORT A CURRENT SERVICES BUDGET. HOWEVER, AS IN THE PAST, I AM LIKELY TO DIFFER ON THE ALLOCATION OF THE AVAILABLE RESOURCES AMONG SPECIFIC PROGRAMS AND APPROPRIATIONS ACCOUNTS.

HOWEVER, AS THE RANKING MEMBER OF THIS COMMITTEE AND THE INTERIOR AND RELATED AGENCIES APPROPRIATIONS SUBCOMMITTEE, I AM CONCERNED ABOUT THE IMPLICATIONS OF REQUIRING PROGRAMS TO ABSORB THE BUDGETARY IMPACT OF THE NEW FEDERAL EMPLOYEE RETIREMENT ACT. I AM PARTICULARLY CONCERNED ABOUT THE EFFECT OF THIS POLICY ON REGULATORY AGENCIES SUCH AS THE FEDERAL ENERGY REGULATORY COMMISSION. IN MAKING THIS STATEMENT, I RECOGNIZE THAT LAST YEAR THE CONGRESS REQUIRED FERC TO RECOVER ITS DIRECT AND INDIRECT COSTS THROUGH THE USE OF FEES AND ANNUAL CHARGES.

NEVERTHELESS, I REMAIN CONCERNED. THE COMMISSION SERVES A SIGNIFICANT ROLE IN ASSURING THE RELIABILITY AND ECONOMIC VIABILITY OF OUR COUNTRY'S ENERGY SUPPLY SYSTEM. THE CAPABILITY FOR TIMELY ACTION BY THE COMMISSION IS CRITICAL. BUT THIS CAN ONLY BE ACHIEVED WITH AN ADEQUATE, QUALIFIED STAFF.

In addition, I am concerned in the event of a sequester under the Gramm-Rudman-Hollings Act. Such sequesters are applied on the basis of total program activity, not after offsetting collections. Therefore, the possibility exists that fees collected for services may be sequestered. And the greater the fees the greater the amount sequestered. The implications of such a sequester on regulatory agencies, such as the Commission, could be significant.

I know that Commissioner Hesse intends to address this matter and other issues here today.

* * * * * * * * * *

Mr. Chairman, I also wish to make a brief statement before we hear from George Dunlop, Assistant Secretary for Natural Resources and Environment, Department of Agriculture, and Dale Robertsen, Chief of the Forest Service.

The livelihoods of millions of Americans are interwoven in the management of our national forests. Besides their recreational uses, a multiplicity of goods and services are dependent on effective management of this living national resource. Over the last six years there has been a significant redirection of the policies and programs for management of our National Forest System. This redirection has resulted in greater management emphasis on production and increased development of our national forests as a vital natural resource.

WE ALL HAVE DIFFERENT OPINIONS ON WHICH PROGRAMS OF THE FOREST SERVICE SHOULD BE EMPHASIZED, AND THOSE OPINIONS WILL BE OBVIOUS FROM THE QUESTIONING. HOWEVER, AT THIS TIME, I MUST NOTE THAT ONCE AGAIN THE ADMINISTRATION PROPOSED TO DISTRIBUTE STATE TIMBER RECEIPTS ON A NET RATHER THAN GROSS BASIS. SUCH AN ASSUMPTION IS A CONVENIENT RUSE FOR THE PURPOSE OF BUDGET SCORING, BUT IT IS JUST AS UNREALISTIC TODAY AS IT WAS WHEN FIRST PROPOSED.

THANK YOU, MR. CHAIRMAN.

STATEMENT OF HON. PETE V. DOMENICI, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. Thank you, Mr. Chairman.

I understand, Madam Chairperson, that in my absence Senator Bingaman asked a question about the rate differential on natural gas. If you recall, before you were confirmed we discussed that. You told the Committee then that you would look into it. You have, and apparently you are doing something about it.

Might I ask, I understand the position that the Commission at least originally has taken is controversial with reference to the Canadians, at least. Can you describe the current status of that situation and, if you might, tell us what you think the Commission is going to do as far as that issue on a permanent basis?

Ms. HESSE. Well, the issue is pending rehearing at the Commission, so I am of course limited in what I can say. I understand, I guess through the same press reports that you read, that the Canadian Government is in fact unhappy with the Commission's decision on Canadian as-billed. I think that, as I told Senator Bingaman, that we feel that we believe in free trade, but we believe in fair and equal trade, as well.

What we did was level the playing field and say that there cannot be differences in the way costs are billed, differences between domestic and imported gas. It is my hope that that decision will stand.

Senator DOMENICI. So it is not the purpose of the Commission to be concerned about whether the Canadians like the decision, but rather to determine whether it is fair or not? Is that correct?

Ms. HESSE. That is correct. And what we did was decide how United States pipelines will bill United States customers. We did not decide anything about how Canadians recover costs. In fact, we would hope that they would continue to enjoy full cost recovery.

All we are talking about is an accounting technique on how those costs will be shown in this country.

Senator DOMENICI. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Nickles.

STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Mr. Chairman, thank you very much.

Chairman Hesse, we welcome you again before this Committee. I read your statement and was interested in kind of being brought up to date on both 436 and 451.

You mentioned in 436 a number of pipelines I guess were transporters and participating in 436. Could you give us a list of those pipelines that are, and also those that have applications?

Ms. HESSE. I have that information, Senator, and I will supply it for the record.

[The information referred to follows:]

Order No. 436
Blanket Certificate

Company	Docket No.	File Date	Order Date
Gas Gathering Corp.	CP86-129-000	11/1/85	12/5/85
Valley Gas Trans., Inc.	CP86-171-000	11/1/85	11/29/85
Mid Louisiana Gas Co.	CP86-214-000	11/26/85	2/11/86
Columbia Gulf Trans. Co.	CP86-239-000	12/13/85	2/25/86
Columbia Gas Trans. Corp.	CP86-240-000	12/13/85	2/28/86
Ozark Gas Trans. Sys.	CP86-250-000	12/24/85	
Gas Transport, Inc.	CP86-291-000	1/24/86	5/21/86
Valero Interstate Trans. Co.	CP86-300-000	1/30/86	7/25/86
Consolidated Gas Trans. Co.	CP86-311-000	2/10/86	
Erie Pipeline System	CP86-330-000	2/14/86	
Transylvania Gas P/L Co., Inc.	CP86-334-000	2/14/86	
Seagull Interstate Corp.	CP86-364-000	3/7/86	7/2/86
Texas Eastern Trans. Corp.	CP86-379-000	3/13/86	12/19/86
Superior Offshore P/L Co.	CP86-387-000	3/17/86	8/15/86
Northern Border P/L Co.	CP86-395-000	3/19/86	
Transco Offshore Gathering Co.	CP86-397-000	3/20/86	Withdrawn
Transcontinental Gas P/L Corp.	CP86-405-000	3/28/86	
Northern Natural Gas Co.	CP86-435-000	4/11/86	12/22/86
Washtenaw Pipeline Co.	CP86-445-000	4/15/86	9/16/86*
Standard Gas Marketing Co.	CP86-449-000	4/16/86	Withdrawn
Transco Gas Services Co., Inc.	CP86-452-000	4/17/86	
Moraine Pipeline Co.	CP86-492-000	5/12/86	
Mantaray Trans. Co.	CP86-507-000	5/21/86	
Texas Gas	CP86-521-000	5/30/86	
Sabine Pipe Line Co.	CP86-522-000	5/30/86	8/11/86
Iroquois Gas Trans.	CP86-523-000	5/30/86	
United Gas Pipe Line	CP86-526-000	5/30/86	
Kentucky West	CP86-527-000	5/30/86	8/28/86
Shell Gas Pipeline Co.	CP86-528-000	5/21/86	9/18/86*
Tennessee Gas P/L Co.	CP86-534-000	6/3/86	Withdrawn
Equitable Gas Co.	CP86-553-000	6/6/86	
Northwest P/L Corp.	CP86-578-000	6/20/86	
Natural Gas P/L Co. of Amer.	CP86-582-000	6/23/86	
Panhandle Eastern P/L Co.	CP86-585-000	6/24/86	
Trunkline Gas Co.	CP86-586-000	6/24/86	
Colorado Interstate Gas Co.	CP86-589-000	6/25/86	
MIGC	CP86-596-000	6/30/86	
Tricentrol Inter. P/L, Inc.	CP86-616-000	7/14/86	
Ringwood Gathering Co.	CP86-618-000	7/14/86	
Northwest Central P/L Corp.	CP86-631-000	7/18/86	
El Paso Natural Gas Co.	CP86-649-000	8/1/86	1/12/87
Western Transmission Corp.	CP86-717-000	9/11/86	
Trailblazer Pipeline Co.	CP86-720-000	9/12/86	
PennEast Gas Services Co.	CP87-4-000	10/2/86	
Blue Dolphin Pipe Line Co.	CP87-31-000	10/20/86	12/11/86
Tennessee Gas Pipeline Co.	CP87-115-000	12/8/86	
Pacific Gas Transmission Co.	CP87-159-000	1/13/87	
Overthrust Pipeline Co.	CP87-165-000	1/16/87	
Northwest Central P/L Corp.	CP87-171-000	1/23/87	

*Determined to be nonjurisdictional.

Senator NICKLES. The summary you mentioned of 13 pipelines, were those major pipeline distribution systems?

Ms. HESSE. Generally, yes. Generally, yes.

Senator NICKLES. And you mentioned several of those you had already taken action on, and several you would be within the next few months.

Ms. HESSE. Yes.

Senator NICKLES. What do you estimate to be the percentage of natural gas that would be moving under pipelines that are transporters under 436, say, within the next three or four months? Is that going to be the majority of gas?

Ms. HESSE. Well, it is my understanding from the reports that INGAA has issued that in the previous several quarters that it is about 50–50; 50 percent of the gas is flowing through transportation, and 50 percent is coming through system supply.

It is our hope that by the first of May that the Commission will have considered all of the 436 applications that are currently in-house. That will take into account I would say 90 to 95 percent of the volumes carried by the major pipelines in this country.

Senator NICKLES. If all of those pipeline applications were agreed to, and if all those pipelines were participating, would that increase 436 gas from that 50 percent? Would that make it closer to 60, or 70?

Ms. HESSE. Well, clearly it would be an increase, but I cannot tell you right now what the percentage would be. We can calculate that and supply that for the record.

[The information referred to follows:]

Ms. Hesse: Interstate pipelines are transporting third-party gas under various Order No. 436 authorizations: "grandfathered" self-implementing transactions, and Order No. 436. Many of the larger pipelines are primarily using Section 311 for "new" Order No. 436 transactions covered by the waivers of the CD reduction/ conversion requirements set to expire no later than May 1, 1987. Some, such as Columbia, El Paso and many smaller systems, are using Section 311 and/or the blanket certificate without any waivers.

The Interstate Natural Gas Association of America (INGAA) conducts an ongoing study of total carriage and total sales representing 87 percent of interstate purchases and production in 1983. For the years 1984 and 1985, respectively, carriage as a share of total throughput is reported at 36 percent and 39 percent, respectively. The first, second and third quarters of 1986 are reported at 40 percent, 58 percent and 67 percent, respectively, for an average of 55 percent. Since the fourth quarter historically drops back to a level between the first and second quarter percentages, the average for 1986 should be about 50 percent. Clearly, most pipelines have (and are using) one or more authorizations to move gas.

Additional participation by such companies as Southern, Natural Fuel, Algonquin, Florida Gas, KN Energy, and PGT would increase transportation volume. Whether it would increase the percentage of carriage as a function of throughput is subject to several factors. First, as the participation under full Order No. 436 authorization increases, the CD reduction/conversion option may be triggered. To the extent that firm customers reduce sales

volumes or convert sales to transportation, or they add to existing interruptible volumes shipped, the percentage of carriage to throughput will increase. To the extent existing transportation volumes remain outside CD levels, or existing interruptible transportation is upgraded to firm, the percentage would not change. Second, the LDCs seem to be taking a cautious approach to revising CD levels. For instance, CD reduction on Columbia Gas' system effective October 8, 1986, amounted to about 2.4 percent. Figures on the order of ten percent overall were suggested by some LDCs at the public conferences leading to Order No. 436. At the same time, Northern Natural's customers agreed to increase their first-year conversion option from 15 to 30 percent, and El Paso's customers have the option to convert 100 percent yet retain sales service on a "standby" basis. Third, whereas pipelines now operating under the waiver are limited to May 1, 1987, and those under Section 7(c) are granted one and two year-terms, longer term contracts will be available under Order No. 436. That security factor could be attractive to potential shippers.

In sum, based on the INGAA trend, the availability of sales/transportation options as a result of CD reduction/conversion and standby service, the availability of longer-term contracts and a rise in the general comfort level with transportation, an increase in transportation to 60 to 70 percent, is possible but by no means definite.

Senator NICKLES. If you would. I am interested to know, because a lot of people have asked, if 436 goes through and many more pipelines are participating, will there be 70 or 80 percent of the gas flowing in the country moving on pipelines that are participating? I think that will make a difference.

I would also think, and I may be wrong, but I have thought in the past that if you had more and more pipelines getting onto the system that that would put a greater push for others to be competitive to do so. Now maybe that is not the case, but I would think that it would be.

Ms. HESSE. Well, that is certainly our belief, that the more interest there is in 436, the more competition it will generate and that it will encourage other pipelines to join, as well.

Senator NICKLES. Mr. Chairman, I do not know if anyone else has dwelled on this. Have you discussed what you will be bringing up in your Commission tomorrow?

Ms. HESSE. Yes. Yes, we did discuss that the Commission will be talking about take-or-pay tomorrow; that at the end of January I did send to my colleagues a proposed take-or-pay solution. We have noticed that we will discuss it tomorrow. We have not noticed the document, and I would prefer not to talk about the specifics of the document, or of the proposed policy today, but rather wait until my colleagues have had an opportunity to talk about it in an open meeting.

Senator NICKLES. Would you supply for the Committee's information after your meeting tomorrow those documents?

Ms. HESSE. Absolutely. And I will be available to come up and to talk to any of you that would like to talk about it.

Senator NICKLES. I also have a very strong interest in that, and I appreciate that.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Ford.

STATEMENT OF HON. WENDELL H. FORD, A U.S. SENATOR FROM THE STATE OF KENTUCKY

Senator FORD. Mr. Chairman, thank you.

I was a little late this morning, but in reading your testimony, I guess it is on page 6, it said: "The Commission has approved tariff rate filings that permit 17 of 20 major interstate pipelines to provide interim open access transportation service under Order 436."

Can you give me the three that you have not taken care of yet?

Ms. HESSE. The three that have not filed are——

Senator FORD. That have not filed.

Ms. HESSE [continuing]. Are Southern Natural Gas, Florida Gas Transmission, and KN Energy.

Senator FORD. They are the only three. And you say, "even while they are completing negotiation with their customers on permanent settlements." Explain that to me, will you?

Ms. HESSE. Well, the Commission has waived certain provisions of 436, so that for example the contract demand reduction rights, so that pipelines may operate as open access transporters of gas while they are completing settlement negotiations with their various customers.

Senator FORD. Do you have any idea how the negotiations are coming along?

Ms. HESSE. Well, I believe that they are coming along very well. I think that most of the major pipelines have filed settlements, and that the Commission will in fact act on those settlements by May 1.

Senator FORD. Fine. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Weicker had a follow-up.

Senator WEICKER. Thank you very much, Mr. Chairman.

Commissioner, is FERC committed to implementing Order 436, specifically the optional expedited certificate procedures, while they are under court review?

Ms. HESSE. Yes. We believe that we must go forward with Order 436, and if the court remands certain sections of it, then we will take a look at what is remanded and try and fix those parts.

Senator WEICKER. Can you give me assurance that Connecticut will not have a pipeline being built through the State while Order 436 is being appealed? [Laughter.]

Senator FORD. That answer is "no."

Ms. HESSE. I can assure you, Senator, that the Commission—and I know that I speak for my colleagues—the Commission will very carefully review and follow the optional procedure, and make certain that the Iroquois project is fairly and objectively and carefully reviewed.

Senator WEICKER. And as a first step in that procedure, I have your assurance today that as far as the environmental aspects are concerned, those public hearings will be held in Connecticut?

Ms. HESSE. You have my assurance.

Senator WEICKER. Fine. Thank you very much, Mr. Chairman. I have further questions for the record.

The CHAIRMAN. We will submit some additional questions for the hearing record. Those members which have additional questions in writing, if you would get them in by close of business today we will submit those.

Does anyone else have a follow-up question?

[No response.]

The CHAIRMAN. If not, thank you very much, Ms. Hesse. We are always glad to hear from you.

Ms. HESSE. Thank you, Mr. Chairman.

[Subsequent to the hearing Ms. Hesse submitted the following:]

Ms. Hesse: At its February 18, 1987, meeting, the Commission discussed a draft policy statement on the recovery by interstate pipelines of take-or-pay buy-out costs, and decided to issue a statement for public comment after further staff drafting. At present, that drafting, and Commission review of the document, must be completed before issuance. Upon issuance, I will forward a copy to the Committee immediately.

For the Committee's information, the Commission also discussed at the February 18 meeting an order on a Transcontinental Pipe Line Corporation (Transco) settlement which involved the recovery by Transco of take-or-pay buy-out costs. A copy of that order, which was issued on February 20, is attached.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PIPELINE RATES: ORDER NO. 436

Before Commissioners: Martha O. Hesse, Chairman;
Anthony G. Sousa, Charles G. Stalon,
Charles A. Trabandt and C. M. Naeve.

Transcontinental Gas Pipe Line Corporation	)	Docket Nos. TA85-3-29-000,
	)	TA85-1-29-000, TA86-1-29-000,
	)	TA86-1-29-002, TA86-5-29-000,
	)	RP83-137-000, and CP85-190-000

ORDER APPROVING CONTESTED OFFER OF
SETTLEMENT SUBJECT TO CONDITIONS

(Issued February 20, 1987)

I. INTRODUCTION

Before us for review is an offer of settlement filed by Transcontinental Gas Pipe Line Corporation (Transco) to resolve certain issues in the above-captioned dockets and to establish the rates, terms and conditions under which Transco will provide open access transportation service pursuant to Order No. 436, et seq. 1/ The settlement is supported in whole by some parties. But it is contested in whole or in part by many parties. We find that, subject to several modifications, the offer is a just and reasonable resolution on the merits of the issues in this case.

II. PROCEDURAL BACKGROUND

The procedural background to this order is complex. What follows is a brief summary of that history which will aid in understanding the offer of settlement presented by Transco. On March 28,

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1/ Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436 [Reg. Preambles 1982-1985] FERC Stat. & Reg. ¶ 30,665 (1985), modified, Order No. 436-A, [Regulations Preambles 1982-1985] FERC Stats. & Regs. ¶ 30,675 (1985), modified further, Order No. 436-B, FERC Stat. & Reg. ¶ 30,688, reh'g denied, Order No. 436-C, 34 FERC ¶ 61,404, reh'g denied, Order No. 436-D, 34 FERC ¶ 61,405, reconsideration denied, Order No. 436-E, 34 FERC ¶ 61,403 (1986), appeal docketed sub nom., Associated Gas Distributors v. FERC, No. 85-1811 (D.C. Cir. Dec. 12, 1985). (Citations to Order No. 436 and Order No. 436-A, and Order No. 436-B will reference the order and the page in the appropriate volume of FERC Statutes and Regulations. Citations to Order No. 436-C, Order No. 436-D, and Order No. 436-E will reference the order and page in 34 FERC Reports.)

1986, Transco filed an offer of settlement in the above dockets. That offer met with widespread customer opposition and subsequent negotiations culminated with Transco filing, on May 13, 1986, the revised offer of settlement which is now before us.

The record contains over 80 initial and reply comments from Transco's customers, state commissions, and other interested parties. After an initial evaluation of those comments, the panel of presiding administrative law judges (panel) before whom the contested settlement was pending convened a prehearing conference. The conference was necessitated by the judges' concern about the propriety of certifying the offer of settlement to the Commission under Rule 602 of our rules of practice and procedure. 2/ The judges observed that several parties opposed certification of the settlement based on their conviction that the settlement contained costs which presented issues of material fact that could not be resolved by the Commission for lack of substantial evidence of record. The judges addressed only two specific contested issues: (1) the proposed 50-50 sharing between Transco and its customers of costs related to the buying out or down of past and future take-or-pay obligations under Article V of the settlement, and (2) the recovery of $82 million in "transition costs" or deferred gas costs and system imbalances resulting from earlier producer settlements under Article II, Section 3 of the settlement.

The prehearing conference took place on June 12, 1986. To satisfy concerns raised by the various parties and to attempt to avoid an outright rejection of the settlement, it was agreed that Transco would supplement the record on the buyout and transition costs issues by the prepared testimony of its witness and would present the witness for cross-examination in a hearing to commence on June 18, 1986. The hearing covered five days of testimony and cross-examination, from June 18, 1986, through June 23, 1986. At the conclusion of the proceeding, the judges heard oral argument, in lieu of briefs, on the question of the propriety of certification of the settlement under Rule 602 on the record as supplemented. A motion was made on the record to omit an initial decision in order to expedite consideration of the settlement.

On June 26 and June 27, 1986, in two separate certification orders, the panel certified the contested offer of settlement to the Commission and, additionally, certified the question of whether the initial decision could be omitted.

2/ 18 C.F.R. § 385.602 (1986).

After reviewing the record certified by the panel, the Commission issued an order on September 16, 1986, that severed the transition cost issue and remanded it for further evidentiary proceedings. The Commission did so because it found that substantial evidence did not exist with respect to this issue. 3/ The Commission found, however, that there was sufficient evidence of record on the buyout cost issue and granted the motion to omit an initial decision with respect to this issue. 4/ The buyout issue and the evidence adduced at the June 18 - June 23 hearing with respect to that issue will be considered, in detail, below.

Thus, we now have before us the revised offer of settlement filed by Transco on May 13, 1986, absent the transition cost issue which was severed by our September 16 order and set for hearing. A brief description of the dockets covered by this offer follows.

The lead docket in the case as well as several dockets which follow it involve purchased gas adjustment (PGA) proceedings. As discussed above, the deferred gas costs contained in several of those dockets are the subject of the separate hearing directed by our September 16 order. However, several of those dockets contain other issues which are the subject of the settlement offer.

We begin with Transco's Docket No. TA85-1-29-000, a September 28, 1984 semi-annual PGA filing. The filing was accepted and suspended by the Commission's October 31, 1984 order which permitted it to become effective on November 1, 1984, subject to refund. 5/ The Commission's October 31, 1984 order set for hearing certain issues: (1) the lawfulness of Transco's proposed rates, including gas purchase practice issues, and (2) the appropriate manner of flow-through of Transco's purchased gas costs from Sulpetro, Ltd., Transco's Canadian supplier. Separate procedural schedules were established for the two issues set for hearing. On September 3, 1985, the presiding administrative law judge issued an Initial Decision on the Sulpetro issue. 6/ The decision is pending before the Commission on exceptions to the judge's findings.

3/ 36 FERC ¶ 61,287 (1986). On December 24, 1986, the Commission issued an order which, inter alia, expedited the procedural schedule on the severed issue. 37 FERC ¶ 61,289 (1986).

4/ The Commission's September 16 order is the subject of several requests for rehearing which are addressed in a separate order.

5/ 29 FERC ¶ 61,148 (1984).

6/ 32 FERC ¶ 63,081 (.985).

Docket No. TA85-3-29-000, the second PGA docket before us, was filed by Transco on March 29, 1985, and accepted and suspended by Commission order issued April 30, 1985. 7/ The Commission's April 30 order placed the rates into effect, subject to refund, and set for hearing the issue of Transco's gas purchasing practices, consolidating it with Docket No. TA85-1-29-000 for resolution of that issue.

The purchasing practices issues in Docket Nos. TA85-3-29-000 and TA85-1-29-000 were divided into two issues. The first concerned Transco's purchases of certain Mississippi gas volumes and Transco's prepayments to producers for certain gas volumes (referred to as the Title I issue). The presiding administrative law judge, on October 31, 1985, issued an Initial Decision on the Mississippi volumes and the Title I issue. 8/ That decision is pending before the Commission on exceptions. The remaining purchasing practices issues in the two dockets were the subject of a hearing and are before the administrative law judge.

The third PGA docket, Docket No. TA86-1-29-000, was filed by Transco on October 1, 1985, and accepted and suspended by the Commission's order of November 15, 1985. 9/ The Commission's order established hearing procedures to consider various issues embracing Transco's purchasing practices. The fourth PGA proceeding is Docket No. TA86-5-29-000, filed by Transco on March 31, 1986. The Commission's April 30, 1986 order accepted Transco's filing subject to refund, established hearing procedures, and consolidated the issues set for hearing with the ongoing proceeding in Docket No. TA86-1-29-000. 10/

The proceeding in Docket No. RP83-137-000 began with Transco's filing on September 30, 1983, pursuant to section 4 of the Natural Gas Act (NGA), a rate case to reflect increased costs on Transco's system. The Commission's October 28, 1983, order accepted Transco's filing, suspending it until April 1, 1984, thereafter subject to refund. 11/ A settlement of certain issues in the case was filed

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7/ 31 FERC ¶ 61,129 (1985).

8/ 33 FERC ¶ 63,026 (1985).

9/ 33 FERC ¶ 61,237, reh'g denied, 34 FERC ¶ 61,001 (1986).

10/ 35 FERC ¶ 61,139 (1986).

11/ 25 FERC ¶ 61,144 (1983).

by Transco on April 6, 1984, certified to the Commission on May 10, 1984, and approved by Commission order issued July 25, 1984. 12/ The settlement agreement reserved for hearing and disposition issues related to Transco's interruptible transportation service. Those issues were litigated by the parties and decided by the administrative law judge in an initial decision issued November 8, 1985. 13/ That decision is pending before the Commission on exceptions to the judge's decision.

Docket No. CP85-190-000 involves an application filed by Transco, pursuant to Section 7(c) of the NGA requesting a certificate of public convenience and necessity authorizing firm transportation service for one of its customers under a new Rate Schedule FT. On August 15, 1985, the Commission issued an order consolidating this proceeding with two other Transco applications and established hearing procedures with respect to those issues. 14/ Evidentiary hearings have been scheduled in that proceeding.

III. DESCRIPTION OF THE SETTLEMENT

Transco's settlement involves many complex issues. The description of the settlement which follows will highlight certain of those issues and provide a framework for their discussion and resolution. According to Transco, the world is divided into two distinct time periods -- before April 1, 1987, and thereafter. The period prior to April 1, 1987, is envisioned by Transco to be a nine month "transition period" from July 1, 1986 (Transco's proposed effective date for the settlement) through March 31, 1987. On April 1, 1987, the permanent restructured sales and transportation services would be in place and Transco's customers would then nominate contract entitlements from the sales and transportation services available in the new Order No. 436 world.

A. The Transition Period

During the transition period, Transco's CD and ACQ Rate Schedule customers have the right to remain on the CD and ACQ schedules or to elect firm transportation service, subject to certain conditions, while retaining their ability to call on Transco for sales entitlements under a new MDQ Rate Schedule sales contract. For the CD customer, the election may be limited to the nine-month

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12/ 28 FERC ¶ 61,146 (1984).

13/ 33 FERC ¶ 63,035 (1985).

14/ 32 FERC ¶ 61,225 (1985).

transition period. After April 1, 1987, the customer may revert back to CD service. Alternatively, the customer may elect to convert from CD to MDQ service on a permanent basis. In the case of the ACQ customers, the election is limited to a four-month period from July through October 1986. Customers under the G and OG Rate Schedules have the option to convert to service under the CD Rate Schedule, and then to the MDQ Rate Schedule, if they so desire. During the nine month transition period, the CD and ACQ customers have a "best efforts" obligation to purchase 3/8 of their annual contract levels, and 30 percent of their contract levels during the four month summer period from July through October. Customers that fail to meet the 3/8 level purchase commitment are subject to a take-or-pay funding charge based on actual incurrence of take-or-pay and limited by each customer's deficiency quantity. Customers that fail to meet the 30 percent summer commitment are subject to loss of the elective transportation rights and the credits to minimum commodity bill for transportation quantities. But they have an option to requalify by paying an added charge on transportation quantities. This charge is equal to 15 percent of the CD commodity charge times the quantities by which they were deficient in meeting the summer period commitments. Present limitations on storage injections are eliminated during the transition period so that transportation gas may be injected into storage.

During the transition period, Transco has agreed to reduce its cost of gas to a maximum level of $2.30 per dth. If Transco's actual cost of gas during the period falls below $2.30 per dt, Transco will credit any such overrecovery of gas costs to Account No. 191. Transco also agrees during the transition period to discount its margin for sales service and for transportation of gas from producers participating in settlements or renegotiations with Transco.

New Rate Schedules FT for firm transportation and IT for interruptible transportation are available on July 1, 1986. Transportation service will be available to any person meeting the necessary qualification criteria set forth in those rate schedules, subject to pipeline capacity and reasonable operating requirements.

Subject to the qualification with respect to the satisfaction of the 30 percent "best efforts" purchase commitment during the summer period, described above, long-haul transportation quantities transported by Transco (1) for customers, (2) for customers on behalf of, or as agent for, end-users served by the customers, and (3) directly for end-users served by the customers shall be considered as having been purchased from Transco for purposes of the customers' minimum commodity bill obligations under the sales rate schedules. In addition, the minimum commodity bill level for the ACQ Rate Schedule shall be reduced to 65 percent annually, and such reduced level shall continue to be effective after the transition period.

Transco states that if Commission approval of the settlement provides for an effective date later than July 1, 1986, the transition period "best efforts" commitments set forth in the settlement will be reduced proportionately. We shall address this and the other issues outlined above in our discussion which follows.

B. The Transition Period and Beyond

On April 1, 1987, and for the period thereafter, customers would then nominate contract entitlements from among the sales and transportation services to be effective on that date.

As noted above, the new FT and IT transportation rate schedules would be available on July 1, 1986. Customers would have the ability to nominate service under the MDQ Rate Schedule which contains standby sales service. For MDQ service continuing beyond the transition period, the take-or-pay responsibility, the loss of transportation rights and minimum commodity bill credits for failure to meet the 30 percent summer period level are provided in the same manner as during the transition period. Customers may elect to return to the CD Rate Schedule after electing the nine-month transition period MDQ service, in which event their rights to contract conversions and reductions shall be limited to those rights provided under Order No. 436 and Order No. 436-A.

During the transition period, all PGA procedures were to be suspended. On April 1, 1987, Transco proposes to implement new PGA procedures which comport with the flexible PGA concept approved by the Commission in other proceedings.

As discussed above, the settlement purports to resolve various issues pending in the above-described dockets. Those, and all other issues in the settlement, will be discussed in detail below.

IV. ISSUES RELATING TO COST RECOVERY AND THE TRANSITION TO OPEN ACCESS

As part of an overall comprehensive plan to address its gas supply problems, Transco has sought to restructure its gas purchase contracts so that they will be more responsive to future market conditions. Transco states that it is endeavoring to resolve gas purchase contract problems through settlements and negotiated contract revisions with its producer-suppliers. To that end, Transco has entered into various agreements with its producer-suppliers to buy out or buy down contract obligations. Transco has, at this stage, expended certain amounts to buyout and revise certain contractual obligations. Transco also faces substantial take-or-pay liability. Transco views the resolution of gas supply contracts as a necessary predicate to achieving open access on its

system and the elimination of the uncertainty of cost recovery as a natural corollory to reaching open access through a restructuring of Transco's outstanding take-or-pay liability. 15/

A. Buyout Costs

Transco has proposed two means of resolving its gas supply problems. The first is through recovery of buyout costs. Article V of the settlement provides for the recovery of costs associated with those settlements and negotiations. Pursuant to Article V, the costs will be shared 50 percent by customers and 50 percent by Transco, subject to a confidential cap on the dollar amount. 16/ The buyouts relate to "covered reserves." These are defined as reserves dedicated under contracts existing as of the date on which the Commission approves the settlement as well as reserves previously dedicated to Transco under contracts which have since expired or terminated but which are still being purchased by Transco as of the date on which the Commission approves the settlement. Article V also provides that any non-recoupable cash outlays paid by Transco to an affiliate in settlement of contract liabilities for covered reserves shall not be recoverable either pursuant to this provision or otherwise in Transco's rates.

The settlement provides that the customer share shall not exceed the total dollar amount of principal. In other words, any dollars expended above the total dollar cap shall be absorbed by Transco. Also, except for their 50 percent share of the confidential dollar amount, Transco's customers shall not bear any further costs for resolution of such contracts with respect to covered reserves. Under Article V, Transco agrees that it shall not: (1) include in any future rate proceedings any costs associated with take-or-pay obligations, or settlements thereof, related to covered reserves; or (2) assign directly to customers under the take-or-pay funding mechanism mentioned above, any take-or-pay costs related to covered reserves unless and until renegotiations or settlements have been achieved. 17/ The costs to be recovered under Article V, however, are deemed to be prudent and recoverable in rates, and shall not be subject to further review by the Commission under the NGA or the

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15/ See Transco's Reply Comments at 56-58.

16/ The confidential cap is subject to a protective order in this proceeding.

17/ Transco reserves the right, however, to seek to recover in its sales rates the costs incurred under contracts not related to covered reserves.

Natural Gas Policy Act (NGPA). Transco agrees to furnish to Commission staff, interested state commissions, and to those customers which share the buyout costs, information to verify the nature of, and incurrence of, such costs. Transco, however, states that to the extent such information is proprietary and confidential, it shall be furnished on that basis.

With that information, we turn to the mechanics of the implementation of Transco's proposal. The costs are to be borne by Transco's sales customers commencing on July 1, 1986, over a 60-month period ending on June 30, 1992. Charges will be based on each customer's applicable billing determinants which are set forth in the tariff sheets in Appendix A of the settlement. 18/ The charge will be calculated at 9.0 cents per dth of Daily Entitlement Quantity per month, and 0.66 cents per dth (0.56 cents per dth for G, OG, PS and X-20 Rate Schedules) of Monthly Entitlement Quantity for each $50 million of costs incurred by Transco as of July 1, 1987. If the maximum customer contribution level has not been reached as of that date, then additional costs, if any, up to the maximum customer contribution level shall be accumulated until July 1, 1988, and, if necessary, in successive twelve-month periods until July 1, 1991. Customers shall also have the option to make an annual lump sum payment within 30 days after notification from Transco as to the amount of such lump sum payment. For those customers who do not elect the lump sum payment method, interest shall be collected on the customers' share of buyout dollars at 9.5 percent per annum.

As part of the negotiation of the entire settlement and especially Article V, Transco's customers have requested, and Transco has agreed, that Transco should continue to perform its merchant function, i.e., as a buyer and reseller of natural gas under long-term gas supply and resale contracts. The performance of Transco's merchant function, however, is subject to certain risks and rewards pursuant to a variable cost recovery mechanism applied to the producer settlement and renegotiation costs, as set forth in Section 4 of Article V of the settlement (the "Incentive Mechanism").

The incentive mechanism works like this. The charges or principal lump sum payments described above are subject to adjustment (increase or decrease) during years 2 through 5 of the five-year

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18/ The determinants utilized in calculating the buyout costs are based upon contract demand as of December 31, 1985 for all rate schedules except ACQ which is determined as annual contract quantity divided by 365, and PS which is annual capacity divided by 365.

period based upon Transco's performance of its merchant function relative to the performance of other pipelines purchasing most of their gas supplies in the Gulf Coast area, as measured by comparative gas supply acquisition costs. Transco shall be deemed to be an "average" merchant (in which event, no adjustment will be made) if Transco's average cost of purchased gas, as defined in the settlement, is within 10 cents per Mcf (plus or minus) of the weighted average cost of purchased gas, as reflected on the same basis, for certain pipelines listed in section 4. For every 1 cent per Mcf that Transco's cost of purchased gas is less than, or exceeds, the range computed for an average merchant, the charges or principal lump sum payment made with respect to the buyout costs shall be adjusted by 2 percent up or down, as the case may be.

Several commenters object to the incentive mechanism provision. Felmont Oil Corporation (Felmont) argues that it is an attempt by Transco to provide itself with an extra profit incentive to purchase natural gas at a price below a defined group of pipelines. Felmont argues that a pipeline should not be permitted to increase its margin solely because it is able to purchase gas below a defined price. Virginia Natural Gas (VNG) is concerned that the mechanism does not make it clear that Transco will not retain the right to recover shortfalls in its sharing of producer-supplier settlement costs in future periods that result from its failure to maintain its gas acquisition costs in line with those of other Gulf Coast pipeline purchasers. Philadelphia Electric Company (PECo) argues that the incentive provision must not change the total dollar amount of the customers' buyout responsibility.

Transco argues that the provision was negotiated to provide Transco's customers added assurance that Transco will have incentive to perform its merchant obligations efficiently. If Transco's gas acquisition costs are below the average acquisition costs of other Gulf Coast pipelines, Transco's customers benefit and Transco may be rewarded as well. If not, Transco may be penalized financially. Transco states that it is amenable to the clarification sought by VNG, namely, that, if Transco is penalized in one period for less than average performance, it will not be entitled to recoup such penalty amount in some subsequent period.

This provision has been negotiated between Transco and its customers in conjunction with the sharing of buyout cost responsibility, and as an added incentive measure to Transco to maintain its merchant function in a manner that will benefit Transco's customers. We do not believe that Felmont or PECo have offered any persuasive reasons for eliminating this provision.

The issue raised by the provisions contained in Article V of the settlement is whether the passthrough of costs is just and reasonable under section 4 of the NGA, and whether it is consistent with the Commission's April 1985 Policy Statement on Take-or-Pay. 19/ Several parties argue that it is not. They advance several arguments in support of their contentions.

There are essentially four types of arguments made. The first is that the proposal conflicts with Order No. 436 which rejected a "safe harbour" for take-or-pay costs and simply reaffirmed the Commission's April 1985 policy statement on take-or-pay. 20/ Several parties, including the Pennsylvania Office of Consumer Advocate (Pa. OCA) and PECo have made this argument. We disagree.

The Notice of Proposed Rulemaking in RM85-1 proposed to offer pipelines a rebuttable "safe harbour" presumption of prudence for certain one-time payments made to extinguish all minimum payment or purchase obligations in certain qualifying contracts. 21/ The purpose of the proposal was to help pipelines resolve take-or-pay problems in certain problem contracts. The proposal was opposed by many commenters to the proposed rule and was rejected by the Commission in the final promulgation of Order No. 436. 22/ The Commission's rejection of the "safe harbour" provision was based on its perception that such a presumption might actually raise buyout costs and hinder contract renegotiation. 23/ Accordingly, the Commission did not promulgate Part B of the proposed rule and, instead, reaffirmed its April 1985 policy statement. 24/

19/ Regulatory Treatment of Payments Made in Lieu of Take-or Pay Obligations, [Regulations Preambles 1982-1985], FERC Stat. & Reg. ¶ 30,637 (1985).

20/ Order No. 436 at 31,463.

21/ Notice of Proposed Rulemaking, Docket No. RM85-1-000, FERC Stat. & Reg. ¶ 32,408 (1985).

22/ Order No. 436 at 31,563.

23/ Order No. 436 at 31,560-62.

24/ FERC Stat. & Reg. ¶ 30,637 (1985).

In rejecting the safe harbour provision, the Commission expressed its concern that the presumption of prudence would allow pipelines to pay at least that amount, thereby increasing total costs. This concern is not presented by Transco's proposal for there is a fixed cap on the total amount Transco may recover. 25/ In addition to the fact that there is a cap on the total dollar amount of customer responsibility, any dollars expended by Transco beyond the amount in the settlement will be borne by Transco and its shareholders. Additionally, Transco's customers will not be responsible for bearing any future costs associated with "covered reserves." There is also the good merchant mechanism which will provide a check on Transco's gas costs and will decrease the customers' share of buyout costs if Transco's purchased gas costs exceed the settlement formula. Thus, we believe that many of the reasons which militated against Commission approval of take-or-pay relief in the promulgation of Order No. 436 do not exist here in the context of the settlement negotiated by Transco and its customers.

Nor is Transco's proposal inconsistent with the policy statement accepted in the final order. The Commission's April 1985 Policy Statement simply determined that payments made by jurisdictional pipelines to first sellers of natural gas for revising or waiving take-or-pay obligations may be recovered in a section 4(e) rate filing. The policy statement further determined that customers would have an opportunity to review the prudence of such costs in the section 4 proceeding.

We find that Transco's proposal to share with its customers, on a 50-50 basis, the buyout costs at the amount agreed to in the settlement, represents a reasonable attempt by Transco to extricate itself from certain problem contracts and to enter the era of open access transportation without these burdens. We do not believe our policy statement is to the contrary. In that statement, the Commission expressed encouragement for pipelines who sought to buyout or buy down take-or-pay liability:

> The Commission is well aware of the industry's ongoing efforts to adjust the underlying wellhead contracts to better reflect current market realities. We believe that one workable approach to this problem is the payment of one-time non-recoupable amounts in exchange for contractual revision or termination. 26/

25/ Although there is a fixed cap on the total amount of dollars to be expended, the surcharge for each customer may be adjusted pursuant to the incentive mechanism described supra, at page 10.

26/ FERC Stat. & Reg. ¶ 30,637 at 31,303.

We do not believe that a full review of the underlying prudence of each contract at issue is a necessary predicate to approval of Transco's settlement proposal. We find this is true for several reasons. First, the total dollar amount to be shared by the customers is subject to a known cap. Transco shares fully in these costs and any dollars expended above the cap will come out of Transco's own pocket. Second, Transco has agreed to provide information to our staff, the customers responsible for the costs, and interested state commissions and agencies relative to the nature and incurrence of such costs. Of equal importance is the fact that Transco's customers' liability has a beginning and an end. The customers will not be responsible for bearing any future costs associated with the covered reserves included in the buyouts. And, last, the good merchant mechanism provides an additional check on Transco's behavior and will decrease the customers' liability if Transco's costs exceed the incentive set forth in the settlement.

A third type of argument has been made by several customers, including Columbia Gas Transmission Corporation (Columbia) and the Pa. OCA. These parties argue that customers are being asked to accept the buyout costs on "blind faith" and that such acceptance gives Transco carte blanche to do as it pleases with respect to the costs. 27/ We disagree.

As discussed above, a hearing was established by the presiding administrative law judges in order to supplement the record in the settlement with respect to the transition costs issue and the buyout issue. The testimony provided by Transco at the June 18 through 23 hearing provided additional information on the nature of the buyouts. Transco's witness testified on, and offered an exhibit with respect to, amounts expended on the buyouts to date and what type of contracts were covered by the renegotiated agreements. The witness testified that Transco's estimate of accrued potential take-or-pay liability is $981.8 million. At the time of the witnesses' testimony, negotiations had been completed 28/ with producers accounting for approximately 77 percent of current deliverability on the system. 29/ The total cost of the settlements

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27/ See Columbia, Initial Comments at 6; Pa. OCA Initial Comments at 7.

28/ The witness defined "completed negotiations" as those either with executed agreements, agreements in principle awaiting the necessary documentation, or where substantial agreement has been reached on major issues. See Miller testimony at 4.

29/ Miller testimony at 4.

is $112.3 million or 15.6 cents for each dollar of Transco's estimate of claimed liability. 30/ With respect to future contract liability, the witness testified that Transco had succeeded in renegotiating with producers representing 77 percent of current deliverability, at a cost of $198.3 million or 7.2 cents for each dollar of Transco's estimate of such potential liabilities.

In addition, the witness testified that it was his belief that contracts covering an additional 11 percent of current deliverability could be settled on substantially the same basis as that which had been settled with respect to potential take-or-pay liability, and if that were achieved, Transco would have settled past, present, and future liabilities on contracts covering approximately 88 percent of its deliverability for 9.5 cents for each dollar of the estimate of liability. 31/ Importantly, the witness noted that of the settlement amounts discussed above, approximately 87 percent will have been expended to resolve problems predominantly under contracts where Congress has established the just and reasonable rate (e.g., NGPA Sections 104 and 102(d)). These are contracts which have been certificated by the Commission and, therefore, have been deemed to be just and reasonable.

All parties who participated in the hearing had the opportunity to cross-examine Transco's witness on the buyout issue. 32/ No specific allegations of imprudence were raised with respect to these costs. The Pa. OCA sponsored a witness who testified that it was his belief that Transco may have been imprudent in incurring the costs included in the settlement. But he was unable to conclude that the costs were imprudently incurred. 33/

Additionally, we note that Transco's customers who are responsible for the buyout costs will be provided with periodic information to verify the nature and incurrence of the costs. Thus, the customers will be able to see that the costs for which they are billed are consistent with the costs we have found reasonable in the settlement.

30/ Miller Testimony at 4.

31/ Miller Testimony at 5.

32/ See Tr. at 574-75.

33/ Tr. at 1009.

One customer, Columbia, has raised objections to the direct billing procedure. Columbia argues that all the buyout costs should properly be recovered through Transco's commodity rate. Columbia argues that by placing the buyout costs in the commodity rate, Transco will be forced to bargain harder for renegotiations with its producers. Columbia argues further that direct billing treatment insulates Transco from the competitive pressures of the marketplace because it assures Transco recovery of one-half of the buyout costs.

As we have discussed above, we believe that the fact that Transco shares at least 50 percent of the buyout costs (and is responsible for any costs expended over and above the cap) provides assurance that Transco will drive the best bargain possible. We believe this equal-sharing approach provides sufficient incentive to Transco to keep its costs of renegotiation as low as possible and to bargain for competitively priced gas as part of those renegotiations. Where, as here, the pipeline has agreed to bear 50 percent of the costs of buying out and buying down its existing contractual liabilities, we believe it is reasonable that the pipeline be assured of recovery of those costs. We believe this approach strikes an equitable balance. For these reasons, we find Transco's proposal to be in the public interest, and we shall approve it. 34/ However, with respect to the billing of the costs, we find it preferable to use a demand surcharge rather than a direct billing method to provide recovery of the costs. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to reflect a demand surcharge to recover the customer's 50 percent share of the buyout costs.

One additional matter merits attention. The settlement provides for interest at the rate of 9.5 percent per annum. Although some parties conditioned their support for the buyout costs on our modifying the settlement to exclude any interest, we believe it would be inequitable to disallow Transco interest on the amounts to be paid out in settlement of the take-or-pay claims.

34/ This is not the first time the Commission has approved the passthrough of buyout costs in the context of a settlement. See, e.g., Trunkline Gas Co., 33 FERC ¶ 61,069 (1985); Columbia Gas Transmission Corp., 31 FERC ¶ 61,307 (1985). See also Columbia Gas Transmission Corp. v. Tennessee Gas Pipeline Co., 31 FERC ¶ 61,053 (1985), where the Commission approved a flow-through mechanism proposed by Tennessee for funding take-or-pay liabilities.

We shall, however, modify this provision to allow interest to be collected in accordance with our regulations concerning interest to be paid on refunds. 35/

B. Take-or-Pay Surcharge Mechanism

Transco's second approach to the resolution of its gas supply problem is a take-or-pay surcharge mechanism. This mechanism is found in Appendix C of the settlement. Transco proposes to fund future take-or-pay liability through this surcharge which would function in the following manner. If during an annual period beginning on November 1 of each year and ending on the following October 31, a customer fails to purchase 50 percent of its contract demand (under the CD or MDQ Rate Schedule; under the ACQ Rate Schedule it would be the customer's annual contract quantity), then the customer shall pay an annual prepaid gas cost carrying charge amount (Annual Carrying Charge) and a settlement reimbursement payment (Reimbursement Payment). The amounts to be allocated and directly billed will be determined on an annual basis.

In other words, Transco's proposal is to track the carrying charges associated with take-or-pay prepayments and amounts paid to settle gas prepayment claims. In Texas Eastern Transmission Corporation (Texas Eastern), 37 FERC ¶ 61,089 (1986), we rejected a similar proposal by Texas Eastern in its Order No. 436 settlement. There, we noted that the Commission's policy does not favor trackers. Section 154.38(d)(3) of our regulations provides that changes in a specific component of the cost of service should not be automatically adjusted, or tracked. 36/ Instead, our regulations say that a change should be considered together with other changes in the context of a section 4 rate case. For this reason, the Commission in Texas Eastern rejected a similar proposal. However, the issue presented to the Commission in Texas Eastern was different in one significant respect. There, we noted that Texas Eastern had incurred no take-or-pay liability. That distinction does not hold true for Transco. As we noted in our discussion of the buyout issue, Transco does face substantial take-or-pay liability.

In its most recent section 4 filing in Docket No. RP87-7-000, Transco filed pro forma tariff sheets to provide for an almost identical surcharge mechanism. In the Commission's order issued November 5, 1986, that issue was set for hearing in the rate case. 37/

35/ 18 C.F.R. § 154.67(c)(2)(iii)(A) (1986).

36/ 18 C.F.R. § 154.38(d)(3) (1986).

37/ 37 FERC ¶ 61,089 (1986).

There, the costs can be examined and the parties can present evidence on this issue. Accordingly, we shall defer consideration of this issue and permit it to be tried in Transco's rate case in Docket No. RP87-7-000, where, we believe, it can be more properly examined.

In making the determination to set Transco's proposal to track take-or-pay costs for hearing, we recognize that Transco has substantially reformed its existing contractual arrangments with its producer suppliers. Thus, any take-or-pay costs should relate to future periods. While Transco's proposal establishes a mechanism for tracking such future costs, we believe that the proposal, as outlined, errs by continuing to treat the symptom rather than the disease. Under the tracking mechanism proposed by Transco, there is insufficient incentive for the pipeline to curb the future build-up of take-or-pay costs. We believe that a more effective approach would be to encourage the establishment of realistic customer entitlements and thereby prevent future accumulation of take-or-pay costs.

To that end, we encourage the parties and our staff to consider methods of collecting such future take-or-pay costs on a current basis so that the charges (1) are known to the customer in advance; (2) are based at least in part on the amount of service the customer has requested; and (3) reflect the cost of the gas inventory Transco is carrying to meet the requested service.

One point needs clarification, however. Originally, Transco had included the take-or-pay surcharge mechanism as part of the MDQ Rate Schedule. In response to opposition from staff, Transco removed this provision from the tariff and placed it in a separate appendix, Appendix C. In Article III, Section 1, Subsection B, Transco states as follows:

> Although the take-or-pay responsibility feature is set out in Appendix C hereto rather than in the MDQ Rate Schedule or service agreements, it is understood and agreed that it is an integral part of such MDQ service. If such provision is limited or discontinued as a result of future regulatory action, Transco shall have the right to make a concomitant limitation or termination with respect to the quantity and/or term provisions of the MDQ service agreements.

Several commenters object to this provision, arguing that it gives Transco a right of pre-granted abandonment which is contrary to the requirements of the Natural Gas Act. 36/ Both VNG and Elizabethtown Gas Company (Elizabethtown) argue that Transco should not be allowed to limit or terminate wholesale service without making an appropriate section 7(b) application. We agree. Pre-granted abandoment authorization such as Transco appears to be seeking here is contrary to the public interest. Accordingly, we shall condition our approval of the settlement on Transco eliminating this provision from the settlement.

C. Best Efforts Purchase Commitments

In tandem with the take-or-pay surcharge mechanism discussed above, Transco's sales customers assume a "best efforts" obligation to purchase gas. During the nine-month transition period, customers have a best efforts obligation to purchase 3/8 of their annual contract levels and 30 percent of their contract levels during the four summer months in the transition period (i.e., July-October). Failure to meet the 3/8 level obligation will subject a customer to the take-or-pay funding charge described above. Failure to satisfy the 30 percent best efforts obligation will result in the loss of firm transportation for CD and ACQ customers who have exercised their option to convert a portion of their firm sales entitlements to transportation. The customer will also be disqualified from any credits for transportation quantities in satisfaction of their fixed cost minimum commodity bill obligations, as would otherwise be provided by the settlement. After the transition period, for customers who elect long-term MDQ service, the take-or-pay responsibility, the loss of transportation rights and minimum commodity bill credits for failure to meet the 30 percent summer period best efforts level, are provided in the same manner as during the transition period.

Several arguments have been raised against these provisions. The arguments fall into two categories -- those who argue that the provision is simply impermissible under Order No. 436 and those who do not object, per se, to the best efforts commitments but believe the penalties attached to them are too rigid.

The Carolina Utility Customers Association (CUCA), Columbia, the Maryland Peoples' Counsel (MPC), the Process Gas Consumers Group (PGC), Southern Natural Gas Company (Southern), and Texas Eastern Transmission Corporation (Texas Eastern) all argue that the

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38/ See Initial Comments, Consolidated Edison at 2-3; Elizabethtown, Initial Comments at 23.

provisions are anticompetitive and contravene the open access mandate of Order No. 436. 39/ For example, the CUCA and others argue that Transco's best efforts obligations are really another form of a nondisplacement policy, albeit in a subtler form. The CUCA argues that in Order No. 436 the Commission expressly rejected any tying arrangements between transportation and other services. 40/ PGC, Fina Oil and Chemical Company, Fina Oil and Gas, Inc., and Fina Exploration, Inc. (hereafter, Fina) and MPC, among others, argue that the best efforts purchase obligations are essentially a reimposition of a minimum commodity bill invalidated by the Commission in Order No. 380. 41/ MPC argues that the minimum purchase levels established in the settlement will effectively preclude meaningful transportation for local distribution companies (LDCs) during the transition period because the levels are so high that they will force customers to buy gas from Transco. 42/ PGC and Public Service Company of North Carolina, Inc. and North Carolina Natural Gas Company (Public Service and N.C. Natural) argue that the best efforts arrangements restrict end-user access to transportation. This is so, the parties argue, because to the extent a local distribution company (an LDC) transports gas for end-users, the LDC would directly increase its own exposure to the penalties of take-or-pay, loss of transportation rights, and loss of minimum bill credits. 43/ Thus, these commenters argue that the sanctions would put pressure on LDCs to deny them transportation whenever the volumes would compete with Transco's sales.

39/ See CUCA Initial Comments at 7-9; Columbia Initial Comments at 11-13; MPC Initial Comments at 4-6; PGC Initial Comments at 14-17; Southern Initial Comments at 10-14; Texas Eastern Initial Comments at 5-6.

40/ Citing Order No. 436 at 31,495; 31,511.

41/ Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, Order No. 380, 27 FERC ¶ 61,318, FERC Stat. & Reg. ¶ 30,571; Order No. 380-A, 28 FERC ¶ 61,175, FERC Stat. & Reg. ¶ 30,584, aff'd sub nom., Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 106 S.Ct. 1968, 1969 (1986).

42/ MPC Initial Comments at 5.

43/ PGC Initial Comments at 15-16; Public Service and N.C. Natural at 4.

Philadelphia Gas Works (PGW) and certain other parties simply argue that the provisions should be modified either to eliminate the penalties or to soften their impact. PGW suggests that the best efforts obligation be defined so as to take into consideration reduced purchases as a result of warmer than normal weather and market losses. PGW cites the Commission's approval of Columbia's fraud and abuse settlement where Columbia's best efforts purchase obligations were to be reduced as a result of market loss and warmer than normal weather. 44/ Citizens Energy Corporation (Citizens) also cites the Columbia settlement, stating that the Commission there eliminated any penalty or sanction for customer failure to meet the best efforts commitment. Allied Corporation (Allied) and Owens-Corning Fiberglas Corporation (Owens-Corning) argue that some conflict could be avoided if transportation volumes were credited against the best efforts levels.

Several commenters have cited the Columbia fraud and abuse settlement and urge us to modify Transco's proposal to be consistent with what the Commission approved in that case. Columbia's settlement provided, in part, that Columbia's wholesale customers agreed to "make every effort" to meet their good faith purchase projections from Columbia during the settlement period. 45/ Some commenters objected, arguing that the provision was, in reality, a minimum sales guarantee for Columbia. The Commission held that it would not interpret that provision of the settlement as binding Columbia's customers to minimum takes from Columbia.

> [T]he customers simply agree to make every effort to meet their good faith projections . . . of future purchases from Columbia during the settlement period. The customers make no guarantees that they will in fact make such purchases. Although the customers give assurances that they will try to make the projected purchases and will not use the settlement commodity rate as a 'bargaining tool' to arrange other purchases in lieu of these projected purchases, these assurances are subject to 'the uncertainties of weather and the marketplace' (footnote omitted) and so do not prevent the customers from reacting to changed conditions, e.g., in gas supply and demand. 46/

44/ Columbia Gas Transmission Corporation, 31 FERC ¶ 61,307, modified, 33 FERC ¶ 61,344 (1985).

45/ 31 FERC ¶ 61,307 at 61,679.

46/ Id.

In a later order modifying the settlement, the Commission found that those same provisions did not conflict with the open access provisions of Order. No. 436. 47/

The best efforts proposal presented by Transco's settlement differs from Columbia in that the best efforts commitments are enforceable by the penalties dictated by Transco. If the customer fails to meet the 3/8 level during the transition period, it may be subject to the take-or-pay tracker. If the same customer does not meet the 30 percent requirement during the transition period and beyond, it means a loss of transportation rights and minimum commodity bill credits.

We agree with Transco's customers that the best efforts obligations are the type of tying arrangement expressly prohibited by Order No. 436. In promulgating the final rule, the Commission stated that any undue discrimination or preference was strictly prohibited under the rule. "Non-discriminatory access to self-implementing transportation services under section 7 of the NGA and section 311 of the NGPA is a cornerstone of the Commission's final rule." 48/ The Commission offered some guidance as to the types of conduct that it would consider unreasonable and undue. For example, the Commission found that "a refusal by a pipeline to transport gas in competition with its own sales services, is unduly discriminatory or preferential and in violation of the non-discriminatory access condition." 49/

We find that the best efforts purchase obligations, tied to the penalties prescribed by the settlement amounts to a refusal by a pipeline to transport gas in competition with its own sales service. For that reason, we shall reject them. The Commission's holding in Columbia, supra, does not dictate a different result. In Columbia, the customers simply agreed to make every effort to meet good faith projections of purchases established during the settlement period. No penalties attached for failure of any customer to meet its good faith projection. Further, their efforts were subject to the vicissitudes of the weather and the marketplace. In rejecting Transco's best efforts commitment obligations, we really reject the "obligation" and the penalties that attach for failure to meet that obligation. Transco and its customers are free to agree that the customer shall make a good faith effort to purchase gas at the quantities agreed upon in the settlement. However, we shall not penalize customers who are unable to meet those commitments.

47/ 33 FERC ¶ 61,344 (1985). The order is subject to rehearing.

48/ Order No. 436 at 31,494.

49/ Id. at 31,511.

V. ISSUES RELATING TO THE RESTRUCTURING OF TRANSCO'S SALES SERVICE

A. CD Reduction and Conversion Rights Under Section 284.10

The settlement establishes a new sales rate schedule, the MDQ Rate Schedule, under which Transco's sales customers can elect long-term sales service. The MDQ Rate Schedule provides essentially the same features as the existing CD Rate Schedule with an option to conditionally convert up to 50 percent of the MDQ sales level on an annual basis to firm transportation (under the FT Rate Schedule) while retaining on a standby basis the right to call upon sales service for such entitlement quantities. In other words, customers have the right to "swing" from firm sales to firm transportation and from firm transportation to firm sales. Several of Transco's customers have agreed to elect service under this new MDQ Rate Schedule.

During the transition period, discussed above, Rate Schedule CD and ACQ customers may convert to the MDQ Rate Schedule with certain provisos. The ACQ customers that desire firm transportation with the standby option may convert for only the "summer" period (July-October) and then revert to the ACQ schedule. CD customers may convert to the MDQ for the transition period or longer. The service includes a standby charge for the option to call upon full sales entitlement. On April 1, 1987, the CD, G, and OG customers have the option to convert to Rate Schedule MDQ on a permanent basis. Any customer that elects to remain on the CD Rate Schedule, or to return to it after electing MDQ service during the transition period, may do so. Customers electing to remain on the existing CD Rate Schedule have the contract conversion and reduction rights as specified in section 284.10. Customers that elect to remain on or convert to the MDQ Rate Schedule do not have the right to reduce their CD level but may only convert 50 percent of the MDQ level to firm transportation with the right to standby sales service. Additionally, upon at least six months' notice, customers under the MDQ Rate Schedule may convert all or any portion of their MDQ entitlements to FT service.

Under section 284.10, a pipeline that becomes an open access transporter pursuant to Order No. 436 is deemed to have offered its firm sales customers the right to either reduce or convert to firm transportation their firm sales entitlements in "eligible firm sales service agreements." A firm sales service agreement is defined in section 284.10(b) as an agreement between the pipeline and its firm sales customer that was entered into before the pipeline accepts a blanket certificate issued under section 284.221 or begins or continues a new transportation arrangement pursuant to

section 284.102 or 284.243, after June 30, 1986. Article IV, Section 1, of the settlement provides that Commission approval of the settlement will constitute a finding that the new sales agreements are deemed to be effective after the necessary authorizations have been issued, and therefore do not qualify as "eligible firm sales service agreements" as defined in section 284.10. The settlement agreement further provides that upon Commission approval of the settlement, Transco agrees to implement open access transportation pursuant to Order No. 436 and is willing to accept a blanket certificate under secton 284.221 of the regulations.

What all of this means is that customers who enter into the new sales agreements with Transco, which will be deemed to not be "eligible firm sales service agreements", will not have the right under section 284.10 either to reduce their firm sales entitlements or to convert those entitlements to firm transportation. They will instead have only such rights as the new sales agreements provide.

The rights provided to Transco's customers under the new sales agreements differ from the rights provided in section 284.10 in two respects. First, the customers do not have the right to reduce their firm sales entitlements as provided in 284.10(c). Second, the customers have the right under the new sales agreements to convert a portion of their firm sales entitlements to firm transportation but that right is limited. The customers will have the right to convert only 50 percent of their firm sales entitlements to firm transportation if they elect standby sales service. However, upon at least six months' notice, customers under the MDQ Rate Schedule shall be able to convert all or any portion of their MDQ entitlements to firm transportation service.

Several commenters, including PGC, the CUCA, PIGC, and Columbia, question the adequacy of the new firm sales agreements because they do not provide for a reduction in firm sales entitlements during the ten year term of the agreements. 50/ These commenters argue that because the new sales agreements do not provide for any reduction in firm sales entitlements, they do not comply with the requirements of Order No. 436. This is so, they contend, because the failure to provide a reduction option means there will be no "freeing up" of transmission capacity as contemplated by Order No. 436. These parties urge us either to reject these provisions

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50/ See Process Gas Consumers Group, Initial Comments at 21-3; Carolina Utility Customers Association, Initial Comments at 13-14; Pennsylvania Industrial Gas Consumers and South Jersey Gas Company, Initial Comments at 13-14; Columbia Gas Transmission Corporation, Initial Comments at 14.

or to modify the settlement to permit sales customers to reduce their contract demand levels to the extent any potential shippers or gas purchasers are waiting in line for firm transportation or sales service on Transco's system.

Commenters in Texas Eastern's Order No. 436 settlement raised many of these same concerns with respect to new sales agreements under Texas Eastern's settlement. There, we noted that, although the arguments raised valid concerns, we declined to either reject the new sales agreements or condition our approval of them. The reasoning in Texas Eastern is applicable here as well. 51/ Moreover, we note that some of the opposition to the new sales agreements in Texas Eastern arose from the fact that customers executed precedent agreements with Texas Eastern by which they obligated themselves to execute a new sales agreement upon Commission approval of the settlement. Thus, some commenters argued that these precedent agreements unfairly bound customers to an abdication of CD reduction rights as a condition to Texas Eastern's becoming an open access transporter. Here, no such precedent agreements are at issue. One other difference should be noted. Although no reduction rights attach under the new sales agreements, Transco's customers that subscribe to the new MDQ service do have a right, upon six months notice, to convert all or a portion of their new MDQ entitlement to firm transportation service. This, too, is less restrictive than what was provided in the Texas Eastern sales agreements. Moreover, it is less restrictive than the conversion right provided for in section 284.10.

In Texas Eastern, we held that our approval of the new sales agreements did not mean that capacity would be made unavailable for firm transportation. Transco's sales customers now receiving service under the CD Rate Schedule have the option to remain on that schedule. If they do so, they will have available to them the full reduction and conversion rights provided under the regulations. If customers elect to stay on the CD Rate Schedule and exercise their reduction rights under section 284.10, capacity will be made available for firm transportation. We do not know what that amount will be but we cannot now say that it will be so negligible as to preclude the freeing up of any transmission capacity on Transco's system.

More importantly, as we held in Texas Eastern, nothing in Order No. 436 requires sales customers to reduce their firm sales entitlements. Order No. 436 gives customers an option to reduce. Customers who elect new MDQ service will have, in essence, decided

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51/ See discussion in Texas Eastern, slip op. at 3-15.

to forego that option in favor of the services offered under the new MDQ agreement. In Texas Eastern, we examined the reasons the CD reduction right is offered to customers who are served under sales agreements existing prior to the pipeline becoming an open access transporter. In short, the right is offered to customers that executed sales agreements before the pipeline became an open access transporter to provide those customers the opportunity to adjust their CD level to the changed circumstances wrought by Order No. 436. In contrast, customers that execute sales service agreements after the pipeline has opened up do so in "full awareness" of the transportation services available and have made a knowing decision to enter into the agreement. 52/ In Transco's settlement, customers are presented with a clear choice. They may remain on the CD Rate Schedule and reduce or convert their CD entitlements as provided in section 284.10. Or they may sign on to the new MDQ Rate Schedule, forego reduction rights under Order No. 436, but have new rights under that new firm sales service. 53/

The new firm sales agreements provided in the settlement are not inflexible. By their terms, the customers may elect to convert up to 50 percent of their firm sales entitlements to firm transportation during the term of the sales agreement. If they do so, they will be eligible for standby sales service. Thus, while they can avail themselves of the right to convert as much as 50 percent of their firm sales entitlements to firm transportation, Transco will stand ready to provide firm sales service to them. Additionally, as noted above, the MDQ customer may, upon six months notice, convert all of its firm sales entitlements to firm transportation.

We believe that the new sales agreements are in the public interest and do not contravene the open access policy of Order No. 436. Accordingly, we find that the new sales agreements will not constitute "eligible firm sales service agreements" as defined in section 284.10(b) if they are executed after the date Transco accepts a blanket transportation certificate issued pursuant to section 284.221.

52/ Order No. 436 at 31,530.

53/ Our approval of the new sales agreements is not based on an assessment of the prudence of the arrangements made by any particular customer. That is a question each state commission must answer. See Texas Eastern, slip op. at 14.

B. Standby Sales Service

As we noted above, a customer that executes the new MDQ sales agreement may elect to receive standby sales service. Standby sales service allows the customer to "swing" from buying up to 50 percent of its firm sales entitlement under the contract from Transco to buying gas from another supplier and having Transco transport that gas. When the customer elects standby sales service, it pays the standby demand charge on the amount of standby sales service it has elected. In addition, the customer will pay the sales commodity charge if it buys gas from Transco or the standby commodity charge plus the commodity charge for firm transportation under Rate Schedule FT if Transco transports gas for the customer that has been purchased from another supplier.

Many of the same commenters who opposed the reduction/conversion terms offered under the new sales agreements take issue with the standby service as well. Essentially, they argue that the standby option confers an unfair competitive advantage on existing sales customers to the disadvantage of other potential shippers. 54/ Shell Offshore, Inc. and Shell Western E&P, Inc. (Indicated Producers) argue that the standby concept violates the framework of Order No. 436, and gives undue preference to existing CD customers. The fear is that the CD customers will "tie up" all firm pipeline capacity through the payment of the standby charges, thus preventing the operation of open access transportation. 55/ A group calling itself the Producer-Marketer Transportation Group (PMTG) contends that Transco's standby service has created two classes of shippers, preferred and others, and that this type of preference is barred by Order No. 436. 56/

We find no inconsistency between the standby sales service offered under Transco's new sales arrangements and the provisions of Order No. 436. Recently, we found in El Paso and in Texas Eastern that the same type of standby provisions were consistent with the requirements of Order No. 436 and rejected arguments similar to the ones put forth here. 57/

54/ See, e.g., CUCA, Initial Comments at 12; PGC Initial Comments at 24; Indicated Producers, Initial Comments at 3-6.

55/ See Initial Comments of Indicated Producers at 5-6.

56/ See Initial Comments of PMTG at 2.

57/ El Paso, 35 FERC ¶ 61,440 at 62,072; Texas Eastern, slip op. at 16-33.

As discussed in Texas Eastern, section 284.10 provides that a firm sales customer of an open access transporting pipeline may either reduce its firm sales entitlements or convert this entitlement to firm transportation. When the customer exercises the conversion option, it uses the firm capacity available to it under its firm sales agreement to purchase gas from the pipeline for the purpose of having the pipeline transport gas purchased from someone else. When a purchaser elects the conversion option, the pipeline may abandon sales service to the extent of that conversion. 58/ However, as we observed in Texas Eastern, the pipeline is not required to abandon service. As stated in Order No. 436, "this abandonment flexibility is not mandatory; a pipeline at its discetion may choose to retain its section 7 sales certificate in order to stand ready to permit its customers to 'swing' back on to sales service." 59/ If the pipeline chooses to "stand ready" to provide sales service, it may "establish a 'standby charge' for standing ready to provide sales service should the customer wish to automatically resume sales service." 60/ Thus, the standby sales service contemplated by Transco's new sales agreements does not contravene the open access policy enunciated in Order No. 436. Many of the arguments raised herein by commenters were considered and rejected in Texas Eastern, supra.

One such argument is that standby sales service "ties up" capacity on the pipeline and gives a preference to existing sales customers. We disagree. As the Commission observed in Texas Eastern, standby sales service does not tie up capacity.

> The capacity is tied up because the pipeline's certificate and contract with the customer entitles the customer to use the capacity on a firm basis. All that standby sales service provides is that the customer may decide on a daily basis whether to use this capacity to receive gas purchased from the pipeline or gas purchased from someone else. 61/

58/ 18 C.F.R. § 284.10(f).

59/ Order No. 436 at 31,526.

60/ Id.

61/ Texas Eastern, slip op. at 19.

The Indicated Producers and the PMTG argue that standby sales service limits the capacity for firm transportation that is available to shippers that are not sales customers. In Texas Eastern, we rejected that contention and found that even if we were to delete the standby provision from the new sales agreements, a different result would not be achieved. 62/ If Transco's customers were to choose the new sales agreement, absent the standby provision, they would be entitled to the same amount of capacity on Transco's system. If the customers exercised their right to convert a portion of their sales entitlements to firm transportation, no capacity for firm transportation would be available to shippers that are not sales customers. If the customers decided to reject the new sales agreements and stay with the CD Rate Schedule, they would still be entitled to the same amount of firm capacity. They could, of course, exercise the reduction and conversion options provided by section 284.10. If they converted sales entitlements, no firm transportation capacity would be "freed up" to shippers. If the customers reduced their entitlements, capacity would become available. But as we discussed above, in our consideration of the CD reduction option, we held that it is just that -- an option. The customers are not required to reduce their firm sales entitlements. The strong support in the settlement for the standby sales service indicates that many customers would probably not elect that option. Thus, there is no guarantee that even if we were to direct Transco to delete the standby provision from the sales agreements, that any capacity might become available to the complaining shippers as a result.

We find that the conversion option with standby sales service fully comports with the requirements of Order No. 436 and 436-A, and that it is not unduly discriminatory.

The rates proposed by Transco for standby service are unopposed by any party and we shall approve them. However, the development of standby rates for future periods will take place in Docket No. RP87-7-000. We believe that rates for this service should be designed to recover only the costs of providing standby service. Thus, the standby rate should (1) be based on the amount of standby service requested by the customer; (2) include only the costs of facilities necessary to provide the requested service; and (3) include the costs of holding gas inventory, to the extent that take-or-pay costs may not be recovered currently through a separate charge.

62/ See discussion in Texas Eastern, slip op. at 19-20.

C. Terms of MDQ Rate Schedule

As we noted above, certain aspects of the transition period remain in place after the transition period has lapsed. One of those elements is the continuing best efforts purchase obligations under the MDQ Rate Schedule. The best efforts commitment which continues is the summer period 30 percent requirement.

Two things happen under this provision. During the summer period (defined as April 1 - October 31), the buyer must purchase 30 percent of its contract demand. If during any month of the summer period, the buyer fails to meet this obligation, the buyer is deemed to be an "underrun buyer." This designation has the effect of suspending the buyer's right to firm transportation which is available to it, through the conversion plus standby option, under the MDQ Rate Schedule. The buyer can discard the status of being an "underrun buyer" when the buyer meets the purchase obligation. Determinations are made on the 15th and on the 30th of the month as to whether the buyer is no longer an underrun buyer. The second thing that can happen is that the buyer remains deficient at the end of the summer period. If that occurs, the buyer is deemed a "deficient buyer" and as such, the buyer's election for transportation service is suspended until the beginning of the following summer period. The buyer can be reinstated by paying a commodity rate surcharge applicable to the quantity by which the buyer was deficient for the period.

We have discussed the best efforts purchase obligations in section C, above, where we found that they were discriminatory and in conflict with Order No. 436. We need not repeat that discussion here but simply find that the penalties which attach to the best efforts obligations under the permanent MDQ Rate Schedule are no more palatable after April 1, 1987, than they were before. Of course, Transco and its sales customers may, if they wish, agree to a best efforts commitment but without the loss of transportation and other rights for failure to honor the commitments.

D. Article III of MDQ Service Agreement

Article III of the MDQ Service Agreement, entitled "Gas Supply" has provoked some comment. Article III provides that seller may not have sufficient gas supplies in the future to supply the buyer with the quantities of gas specified in the service agreement at "delivered prices which are marketable in all of Buyer's markets, for the term of such Agreement." The provision further states that nothing in that article is intended to limit the buyer's rights in an agency or court proceeding to raise any issue regarding the seller's performance or its obligations under the service agreement.

Consolidated Edison Company of New York (Con Ed) and Elizabethtown object to this provision which they characterize as an exculpatory clause. 63/ Con Ed contends that Transco is attempting to establish a before-the-fact contractual defense against potential liability for imprudent purchasing practices. Elizabethtown claims that the provision ignores the nature of Transco's service obligations. Con Ed and Elizabethtown are the only customers who have raised any objection to this provision. Brooklyn Union Gas Company (Brooklyn Union) states that it interprets the language in Article III of the Service Agreement differently. Brooklyn Union says the intent of the language is not to diminish Transco's continuing duty to exercise due care and prudence in acquiring gas supplies. Rather, the purpose of the language is to protect the pipeline against purchaser claims of misrepresentation of supply availability. That is why, Brooklyn Union contends, the second part of Article III is there, that is, the language which states that buyer's rights to raise issues regarding seller's performance, are not restricted. Transco confirms this interpretation in its reply comments.

We do not find anything particularly troubling in the language of Article III of the service agreement. Transco has stated its agreement to the interpretation and clarification expressed in Brooklyn Union's comments. And, further, in another provision of the settlement (Article I, Section 4), it is clearly stated that nothing in the settlement is intended to "limit or impair Transco's traditional duties as an interstate pipeline merchant (buyer-reseller) of gas." We believe that this provides adequate assurance to Transco's customers that it will continue to exercise due care in its duties as a seller and reseller of natural gas.

E. Transportation for Rate Schedule G and OG Customers

The settlement provides that during the transition period, Rate Schedule G and OG customers may secure transportation service by converting to Rate Schedule CD and thence, to Rate Schedule MDQ. As of April 1, 1987, and thereafter, customers under the G and OG Rate Schedules are able to convert all or any portion of their entitlements to firm transportation service upon at least six months' notice.

63/ Consolidated Edison Company of New York, Initial Comments at 4-6; Elizabethtown Gas Company, Initial Comments at 15-16.

Several of the G and OG Rate Schedule customers, calling themselves the Transportation-Denied Purchasers' Group, object to that portion of the settlement which requires that during the transition period, they must first convert to the CD Rate Schedule and then to the MDQ Rate Schedule in order to obtain transportation. 64/ The reason for the distinction, according to Transco, is that the G and OG Rate Schedule customers now receive a very favorable rate treatment, by purchasing at a one-part volumetric rate equal to the 100 percent load factor CD rate. Transco states that it has not denied transportation to this group of customers. Rather, it has simply required that in order for the G and OG Rate Schedule customers to secure transportation options, they must first convert to Rate Schedule CD and then to the MDQ Rate Schedule.

We do not find anything particularly troubling in Transco's reasoning. This issue was addressed in Order No. 436 in the Commission's discussion of the operation of CD adjustment options. 65/ Specifically, the Commission considered the relationship of the CD adjustment options to full requirement contracts. There, we noted that we did not agree with commenters who argued that customers that previously purchased under a full requirements rate schedule should be allowed to purchase under that rate schedule even though they no longer purchase their full requirements from the pipeline. We stated that there "could be differences in the costs of providing full and partial requirements service. If there are such differences, and if the rates fairly reflect these differences, we can perceive no reason why a partial requirements customer should be allowed to purchase under the full requirement rate schedule." 66/ We stated, however, that if there were disagreements on the question, they could be resolved in individual cases. In Order No. 436-A, several commenters argued that the Commission erred in not addressing the rate question. There, we held that the commenters had failed to raise any argument that would warrant a different conclusion. 67/ We see no reason to reach a different result here.

64/ The Transportation Denied Purchasers' Group consists of the Cities of Greer, South Carolina, Union, South Carolina, and Alexander City, Alabama.

65/ Order No. 436 at 31,529-30.

66/ Id.

67/ Order No. 436-A at 31,668-69.

As stated above, Transco requires that after April 1, 1987, G and OG Rate Schedule customers may convert all or any portion of their entitlements to firm transportation service upon at least six months notice. This is inconsistent with Order No. 436 and the Commission's regulations, which provide that a customer that wishes to exercise the CD conversion option must provide the pipeline with 60 days notice. 68/ However, we recognize that Transco is offering a conversion option that exceeds what is provided in Order No. 436. For that reason, we find that if any customer under the G and OG Rate Schedule wishes to convert a portion of its firm sales entitlements not in excess of the 15 percent provided during the first twelve-month period after the pipeline becomes subject to section 284.10, the customer may do so upon 60 days notice, as provided in the Commission's regulations. However, if the customer wishes to convert all of its firm sales entitlements, or a portion in excess of the 15 percent provided, it must give Transco six months notice.

VI. TRANSPORTATION ISSUES

A. Terms and Conditions of Service

1. Information Required in Applications for Transportation Service

To receive firm or interruptible transportation under Rate Schedules IT and FT, the shipper requesting service must provide Transco with certain preliminary information. These terms are found in section 9 of both Rate Schedule IT and FT. In addition to the information requested, the shipper must pay a certain amount of money before Transco will consider the request for transportation service. The information required by these sections is intended to serve several functions. First, the information is necessary to Transco to enable it to determine whether it has the capacity to provide the service and whether the arrangements the shipper has made to deliver the gas to Transco's system and take the gas off meet the operational conditions of Transco's system. Second, the information provides assurance to Transco that the request for transportation is for a specific transaction. And third, for the shipper, the information establishes the basis for determining the shipper's priority for the first-come, first-served scheme of allocating capacity in accordance with section 27 of the General Terms and Conditions. Several parties object to certain of these provisions.

68/ 18 C.F.R. § 284.10(d)(2) (1986).

Citizens Energy Corporation (Citizens), Fina, and Cheney Energy Corporation (Cheney) all argue that the operating conditions are overly restrictive and require the shipper to supply unnecessary information. 69/ We believe that certain of the concerns raised by the parties are valid ones and we shall address them in turn.

a. Prepayment Charge: Section 9.1 of Rate Schedule FT requires that the request for service be accompanied by a prepayment equivalent to the reservation charge for one month of service. Section 9.1 of Rate Schedule IT requires a prepayment equal to the lesser of $2,500 or the equivalent of one month's revenues for service seller would receive if seller was performing such service at the maximum daily quantity.

Several parties, including Fina, Allied, and Baltimore Gas and Electric Company (BG&E) object to the imposition of the prepayment charge on interruptible service. We agree. Order No. 436 prohibits the prepayment of any interruptible transportation rate. 70/ Order No. 436 requires that rates be volumetric. The customer simply pays for the amount of service used. If the customer does not use the service, it pays the pipeline nothing and the pipeline bears the risk of capacity utilization. 71/ Although under Rate Schedule IT Transco would credit the prepayment to any amount charged to the buyer for the month for which service was requested, the provision is still unacceptable.

Fina objects to the prepayment requirement found in the FT Rate Schedule as well. There is a difference. Order No. 436 clearly permits a pipeline to impose a reservation charge for firm transportation to require the shipper to prepay the reservation charge. 72/ That is all the FT Rate Schedule requires -- a prepayment of the reservation charge for one month of service. Section 3.9 of the FT Rate Schedule also provides that the prepayment will be credited against the buyer's first monthly invoice for service. We find this provision acceptable. However, one further matter requires clarification. Section 9.1 of Rate Schedule FT requires that the prepayment of the reservation charge be made at the time service is

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69/ See Initial Comments of Cheney at 9; Citizens Energy Initial Comments at 10-13; Fina Initial Comments at 10-12.

70/ Order No. 436 at 31,537; 18 C.F.R. § 284.9(d) (1986).

71/ Order No. 436 at 31,536. See also, Texas Eastern, slip op. at 41.

72/ Order No. 436, at 31,536-37.

requested. If capacity for firm transportation is not available and, as a result, a contract between Transco and the customer is not signed, it would not be possible for Transco to credit the first month's bill. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to require that it shall refund the prepayment amount in full within a reasonable time, unless a contract has been executed for the service. We shall also condition our approval of the settlement on Transco filing revised tariff sheets to eliminate the prepayment fee in section 9.1 of the IT Rate Schedule.

b. Third Party Transportation and Proof of Market to be Served

Under both Rate Schedules FT and IT, the potential shipper is required to supply, inter alia, the maximum daily quantity and total quantity to be transported during the requested term of service, the names of the third parties required to transport, treat or process the gas, including sufficient proof that these third party arrangements will be available for the term of service requested and sufficient proof of the market to be served. Fina, Cheney, and Citizens all argue that these requirements are too broad. 73/ Fina argues that Transco does not need either to know the names of all third parties required to transport, treat, or process the gas, or have sufficient proof that these third-party arrangements will be available for the term of the service requested. Both Fina and Citizens express concern that this information is required for the ten year term required by Transco for FT service.

We share many of the same concerns with respect to this requirement in the validation process. We agree that the provision is overly broad and requires information that is not necessary for Transco to consider the application for service. When we approved a similar Order No. 436 settlement for El Paso Natural Gas Company (El Paso), we held that the potential shipper need not tell the company the names of all the upstream and downstream transporters involved in the transaction. 74/ There, we determined that all the pipeline needed to know in order to determine whether it could provide the service requested was the name of the entity delivering the gas into the pipeline's system and the name of the entity taking the gas off. 75/ We are aware that Transco will need this

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73/ See Initial Comments of Cheney at 9; Citizens at 12; Fina at 11.

74/ See El Paso Natural Gas Company, 35 FERC ¶ 61,440 (1986).

75/ El Paso, 35 FERC at 62,062.

information when service commences to enable it to comply with the reporting requirements of section 250. 76/ At that time, the shipper can provide the information. But Transco does not need it at the time service is requested. We shall therefore condition our approval of the settlement on Transco filing revised tariff sheets to modify section 9.1(b) of Rate Schedules FT and IT to provide that the shipper shall be required to provide only the identity of the entity delivering the gas to Transco and receiving the gas from Transco.

The second requirement of section 9.1(b) is that the potential shipper supply sufficient proof that the third party arrangements will be available for the term of service requested and sufficient identification and proof as to the market to be served. The purpose of the requirement is to ensure that the potential shipper has a valid transaction when it makes the request for service. We agree that this purpose is valid. Here, the parties bargained for this provision, in part, out of a concern that requests submitted by Transco's affiliate, TEMCO, be genuine requests in order to prevent TEMCO from locking up firm production area capacity. This is a valid goal and we share the parties' concern with respect to TEMCO. While we share that concern, we do not believe that a general proscription is necessary to achieve that goal. We discussed a similar problem in El Paso. There, we found that El Paso's requirement that a potential shipper provide signed letters of intent between the shipper and the shipper's supplier and signed letters of intent between the shipper and the party designated to receive the gas from El Paso were too restrictive. In El Paso, we said that such a requirement could impose a catch-22 on the potential shipper. 77/ This could occur in a situation where the upstream transporter decided to impose the same requirement on the potential shipper.

We think the same reasoning applies here. Although Transco has not requested letters of intent from potential shippers, the request for proof of valid arrangements and proof of the market to be served, really serve the same purpose. Thus, we find no basis for reaching a different result than in El Paso. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to eliminate this provision. As we stated above, the only information needed by Transco is the identity of the entity delivering the gas to Transco and receiving the gas from Transco.

76/ 18 C.F.R. § 284.106 (1986).

77/ El Paso, 35 FERC at 62,063. See also Texas Eastern, slip op. at 44.

By eliminating these requirements from the validation process, we leave Transco with no mechanism to ensure that frivolous requests for service are weeded out and that a shipper requests service for only a valid and specific transaction. 78/ We held in El Paso and in Texas Eastern that there should be such a mechanism. 79/ In Texas Eastern, we found that the mechanism could be provided by adding certain terms to the tariff. We find the same here. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to incorporate the additional terms in the operating provisions of its tariff:

(1) At the time the shipper requests service, the shipper is required to submit a letter certifying that the shipper has title to the gas, or a contractual right to acquire title, to be delivered to Transco and has entered into or will enter into all arrangements necessary to assure that all upstream and downstream transportation will be in place prior to the commencement of service. 80/

(2) The shipper shall execute the transportation contract within 30 days after Transco has tendered the contract to the shipper. If the shipper fails to execute the contract within 30 days, the shipper's request will be deemed null and void. 81/

(3) Interruptible shippers will be required to begin transportation on the later of: when service is scheduled to commence or 15 days after the contract is executed or all necessary construction has been completed and permits obtained. 82/

(4) The shipper shall not be required to identify the end-user at the time service is scheduled. However, in El Paso, we required the shipper to identify at the time it executes its contract the name of the corporate entity or entities ultimately receiving the gas and include the names in the contract. 83/ We also required the shipper to provide

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78/ El Paso, 35 FERC at 62,062.

79/ El Paso, 35 FERC at 62,062-63; Texas Eastern, slip op. at 45.

80/ Texas Eastern, slip op. at 45.

81/ Id.

82/ Id.

83/ El Paso, 35 FERC at 62,065.

verification that these end-users have signed sales contracts to use the transportation services provided for in the contract. 84/ We shall impose the same requirement here.

c. Use or Lose

Transco has included in the General Terms and Conditions of its tariff (section 27.2(f)) a "use or lose" provision for interruptible service. That provision states that if requests for interruptible service under Rate Schedule IT exceed the capacity which Transco has determined will be available at any receipt or delivery points on its system, the available capacity will be made available to shippers on a first-come, first-served basis. However, if during the "prior 60-day period Buyer has tendered for transportation a quantity less than 80 percent of the lesser of (1) Buyer's maximum daily quantity, or (2) the capacity made available by Seller in response to monthly requests for service in accordance with section 27, then the capacity available to such Buyer will be reduced to an amount no less than the average daily quantity tendered by Buyer during such 60-day period; provided, further, that such adjustment shall not be made if and to the extent that (a) Seller has been unable to transport such tenders during such 60-day period, and/or (b) Buyer's inability to tender has been caused by a scheduled temporary reduction in the quantities being transported, requested by Buyer and agreed to by Seller, or by an event of force majeure (other than a failure of Buyer's gas supplier to deliver quantities for Buyer's account). 85/

The provision has not provoked wide dissent. One commenter, American Paper Institute (API) argues that the provision is unreasonable. API states that if a shipper does not fully utilize a certain receipt or delivery point, Transco can make the unused capacity available on an interruptible basis to a shipper lower on the first-come, first-served list. However, API states, if the original shipper then calls on all of the capacity at the receipt or delivery point originally allocated to the shipper, the later shipper must be interrupted. According to API, this is how the first-come, first-served rule is supposed to work. If the Commission approves this provision, API states, at a minimum Transco should not be permitted to effect a reduction in a shipper's entitlement to interruptible capacity at a receipt or delivery point, when the reduced transportation during the 60-day period is caused by the shipper's supplier and therefore is caused by a

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84/ Id.

85/ See General Terms and Conditions, section 27.2(f).

factor outside the shipper's control. 86/ Citizens Energy disputes certain aspects of Transco's proposed allocation of capacity as set out in section 27.2 of Transco's General Terms and Conditions. However, Citizens states that if those problems were resolved, it would not be opposed to the use or lose it provision. Specifically, Citizens objects to what it describes as the special preference given for TEMCO and other agreements provided in section 27.2(c)(i). In our discussion on Transco's allocation of capacity, we have modified Transco's proposed allocation scheme to provide that Transco shall allocate interruptible capacity on a first-come, first-served basis. (See discussion, infra, at 57-64.) We believe that the modifications we have ordered will address Citizens' concerns.

API seems to want to provide first-comers with a preferential status whether they use the allocated capacity or not, and regardless of any impact upon potential shippers which are awaiting service. In general, API argues that a use or lose it provision is inconsistent with the first-come, first-served principle of Order No. 436. We disagree. Although a use or lose it provision provides a slightly different interpretation of the first-come, first-served rule, we believe it is not per se inconsistent with the principles of Order No. 436.

In El Paso, we declined to adopt a use or lose it provision for interruptible transportation. We declined to impose this provision over the objection of the pipeline and most of the shippers. In our order denying rehearing in El Paso, we reached the same conclusion after receiving comments on that particular issue from El Paso and other parties to the settlement. Here, the situation is different for the reason that the pipeline (Transco) has included a use or lose it provision in its tariff and it is not generally opposed.

For this reason, we find it appropriate to approve the use or lose it provision in this case. In the settlement before us, Transco and its customers have agreed upon this type of mechanism to ensure that potential shippers do not overbook capacity on the pipeline's system. We believe that this mechanism may be appropriate where, as here, the pipeline has proposed it in its tariff and it has not invoked widespread opposition. Accordingly, we shall approve section 27.2(f) of the General Terms and Conditions of Transco's tariff.

86/ API, Initial Comments at 12.

d. Term of Service: Section 9.1(d) of both the IT and FT Rate Schedules require that the shipper shall include the term of service which shall include the date service is requested to commence (which shall not be more than 90 days from the date of such request) and the date service is requested to terminate. The provision also requires that the term of such service shall not exceed the term of the gas supply arrangements. It is this second part of 9.1(d) which has elicited objection from several commenters.

Among others, API, BG&E, Fina, and Citizens voice strong opposition to this provision. BG&E argues that this requirement is particularly onerous with regard to determining priority of service. The argument is this: if an LDC works its way up the first-come, first-served line, it has no assurance that it can maintain its place in line if the term of its underlying gas supply arrangement changes. In other words, if a change in the underlying agreement constitutes "new service" and results in the LDC losing its place in line, this would unduly restrict the LDCs access to low-cost gas supplies. BG&E argue that the buyers of firm transportation service need to be able to change the term of the underlying supply arrangement by extending an agreement with a current supplier or entering into a new agreement. API makes the same argument, stressing the fact that shippers need certain flexibility under their transportation arrangements with Transco, which includes the right to change gas suppliers. API notes that this is especially the case with shippers who buy gas on a month-to-month basis on the spot market.

There are really two questions here. First, is the provision really necessary in light of the modifications we have made to Transco's tariff, discussed supra, to ensure that shippers do not request more capacity than they need for a specific transaction. We have required Transco to amend its tariff provisions to provide assurance to Transco that the requests for service it receives from potential shippers are not frivolous and represent requests for specific transactions. We believe the changes we have required serve that purpose. Second, is this provision consistent with Order No. 436? Transco states that the purpose of these provisions is to qualify requests for transportation, and to prevent customers from needlessly tying-up capacity on the system. 87/

We disagree. In Order No. 436 the Commission provided guidance as to the types of conduct that might be considered unreasonable under the rules. For example, the final rule prohibits discrimination on the basis of "the quality or duration of service

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87/ Reply Comments of Transco at 30.

rendered." 88/ The Commission stressed that the non-discriminatory access condition imposed in the rule and embodied in section 284.8(b) of the Commission's regulations be "construed broadly as a line of first defense against arbitrary or exclusionary transportation practices." 89/ Even construed narrowly, the term of service requirement could act to exclude certain customers.

Furthermore, there is nothing in Order No. 436 that would prevent a shipper from changing its supplier. The arguments presented by the shippers here, that the term provision prohibits them from shopping around for the lowest gas supply, is a valid one. Certainly, one of the principal tenets of Order No. 436 is to encourage such shopping and the competition it engenders.

Two further points are relevant. In the case of firm transportation, we have held that it is proper for Transco to charge the potential shipper a reservation fee when it applies for firm service. We found that the application of the charge was appropriate because, among other things, it would help to ensure that the request for service accompanying the payment of the reservation charge was based on a valid, specific request. In the case of interruptible service, if a shipper does not have a gas supply contract that coincides with the term of service requested and does not use the pipeline for that service, it does not tie up capacity.

Accordingly, we shall condition our approval of the settlement on Transco's filing revised tariff sheets to eliminate this condition from section 9.1(d) of both the FT and IT Rate Schedules.

e. Term of the FT Rate Schedule: Transco's tariff requires that customers who elect firm service under the FT Rate Schedule execute a service agreement with a primary term of ten years. This provision has drawn opposition from the Commission staff, which contends that the long duration of the primary term of service is inconsistent with Order No. 436 because it inflicts an unduly discriminatory access requirement on potential firm transportation. 90/ Staff avers that the provision is in direct conflict with section 284.8(b) of the regulations which provides:

88/ Order No. 436 at 31,495. See also 18 C.F.R. § 284.8(b).

89/ Order No. 436 at 31,511.

90/ Initial Comments of Staff at 4-5.

> Non-discriminatory access. An interstate pipeline or intrastate pipeline that offers transportation service on a firm basis under Subpart B, C, G or H must provide such service without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind. (emphasis supplied).

18 C.F.R. § 284.8(b).

We agree with staff that this is a legitimate concern. In Order No. 436 the Commission recognized that duration of service was a potentially discriminatory item. The Commission there stated that Order No. 436 "prohibits discrimination among customer classes as well as on the basis of minimum volume requirements, the quality or duration of service rendered. . . ." 91/ (emphasis supplied).

We believe that Transco's firm customers should have the opportunity to contract for long term service if they so desire but they should be given the option to negotiate with Transco for a shorter term of service as well. In its Reply Comments, Transco states that it did not intend to preclude the negotiation of shorter term FT service on a case-by-case basis. 92/ However, Transco is opposed to permitting a potential FT shipper to dictate the term of the service. While we believe that the ten year term contained in the FT service agreement is too long and has a potentially discriminatory effect, we believe that the actual term of the service is a matter that can be left to negotiations between the parties. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to eliminate the primary term of service from the FT Service Agreement.

91/ Order No. 436 at 31,495.

92/ See Reply Comments of Transco at 22.

f. Maximum and Minimum Rates, Selective Discounting and Discounts to "Participating Producers": Section 3.5 of the FT Rate Schedule and section 3.4 of the IT Rate Schedule provide that the buyer shall pay the maximum rates for service under the rate schedule unless Transco offers to discount its rate to the buyer. Both sections provide that the rates shall not be discounted below the minimum rate. Essentially, this provision tracks the Commission's regulations which provide that the pipeline "may charge an individual customer any rate that is neither greater than the maximum rate nor less than the minimum rate on file for that service." 93/

Despite that fact, certain commenters have expressed concern with this provision and with another related provision found in Article II, section 7 of the settlement agreement. Article II, section 7 provides that during the transition period, Transco will discount its transportation rate for the transportation of gas originating from gas supply sources "committed under contract by Participating Producers." Article I, section 1 defines a "Participating Producer" as a producer-supplier with whom Transco has concluded or concludes settlements and/or contract revisions in the context of Transco's efforts to implement open access transportation pursuant to Order No. 436.

The above provisions have drawn opposition on two levels. The first concern is that any discounting, pursuant to the FT or IT Rate Schedules could lead to competitive abuse by TEMCO, Transco's marketing affiliate. This fear is articulated in comments filed by Citizens Energy. To allay its concerns in this regard, Citizens requests that the Commission require Transco to publicly post any discount (or change in discount) in its transportation rates at least 30 days before making such discount or change effective. Citizens argues that this requirement would serve to limit TEMCO's ability to use advance information from Transco to TEMCO's competitive advantage in securing or maintaining marketing opportunities. 94/

The concept of selective discounting was considered at some length in Order No. 436. There, we found that given the proliferation of competition in the natural gas industry, "it makes little sense to withhold from pipelines the basic weapon other businesses have to wage the competitive battle: the ability to lower prices to beat the competition." 95/ We specifically addressed the

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93/ 18 C.F.R. § 284.7(d)(5)(ii) (1986).

94/ Initial Comments of Citizens at 16.

95/ Order No. 436 at 31,545.

question of discounts to affiliates and determined that it was not appropriate to prohibit a pipeline from offering a discount to an affiliate. 96/ We addressed the question once again in Order No. 436-A. 97/ We saw no merit to contentions similar to Citizens' in these orders. We see no reason to reach a different conclusion here. Further, we crafted our regulations to ensure that the pipeline would be required to give notice of any discount extended by filing a report with the Commission which identifies the rate charged during the billing period, the shipper, and any corporate affiliation between the shipper and the transporting pipeline. 98/ We believe our regulations provide adequate protection against undue discrimination. Accordingly, we reject Citizens' arguments.

A second, related question is the discount to be provided for the transportation of gas originating from gas supply sources committed under contract by participating producers. Transco has set out in Appendix B to the settlement the discounted transportation rates to be charged pursuant to Article II, section 7, of the settlement agreement. The discount extends only through the transition period.

Commenters who oppose the discount for particpating producers argue that the provision is unduly discriminatory. 99/ Allied argues, for example, that the provision unfairly gives a preference to certain producers on Transco's system who have in the past charged Transco gas purchase rates which were above market levels. And, Allied states, the end-user who cannot or does not purchase gas from a participating producer is discriminated against.

On their face, the provisions providing for the discount to participating producers do not appear to be unduly discriminatory. We note, however, that our approval of the settlement does not connote approval of the level of the discount itself. In addition, Transco must follow section 284.7(d) of our regulations which provides that Transco must file a report with the Commission at such

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96/ Order No. 436-A at 31,546.

97/ Order No. 436-A at 31,679.

98/ 18 C.F.R. § 284.7(d)(5)((iv) (1986).

99/ See Initial Comments of Delhi Gas Pipeline Corporation at 3; Initial Comments of Indicated Producers at 22; Initial Comments of Producer-Marketer Transportation Group at 7.

time as it selectively discounts. Also, as we found in Order No. 436, the manner in which a pipeline exercises the selective discounting authority granted under section 284.7(d)(5) of our regulations remains fully subject to our scrutiny and applicable antitrust laws. 100/

There is one additional matter that merits our attention. Although Transco's firm transportation commodity charges include a maximum and a minimum charge, its reservation charge for firm service contains only a maximum charge. This is inconsistent with the regulations. The reservation charge may recover only fixed costs. However, the minimum rate may include only the average variable costs which are properly allocated to the service to which the rate applies. 101/ The reservation charges are therefore not properly includable in the minimum charge. Accordingly, we shall require that Transco file revised firm transportation rates that include a minimum reservation fee of zero, as required by the regulations.

g. Credit Worthiness: Sections 9.2 of both the FT and IT Rate Schedules provide that Transco shall not be required to perform service or to continue to perform service for any buyer who, in Transco's judgment, fails to demonstrate credit worthiness as determined by Transco. The section provides further that if Transco gives notice of such non-credit worthiness to the buyer, the buyer may continue to receive service by paying to Transco an advance payment equal to two months revenues or furnish a continuing bond or other security acceptable to Transco. Fina states that it has no objection to this provision but argues that if Transco invokes the provisions of section 9.2, Transco should allow the shipper to elect whether to make the two-months prepayment of revenues or to post bond or other security. Then, Fina states, Transco should refund this amount when service is terminated. Citizens states that it understands the need for such protection but argues that Transco should not have the right to refuse service where advance payment is made.

100/ Order No. 436 states that:

> But the basic complaint in this situation is under the antitrust laws. (citation omitted) Our rule does not grant a pipeline immunity from the antitrust laws. (footnote omitted) More important, these complaints are reviewable by the Commission under section 5 of the NGA. (citation omitted) (Order No. 436 at 31,546.)

101/ 18 C.F.R. § 284.7(d)(4)(ii) (1986).

In Order No. 436, we found that "reasonable operating . . . conditions imposed routinely by pipelines or shippers do not per se violate the non-discriminatory access provision, provided that such conditions are stated 'up-front' in the pipeline's transportation tariffs on file at the Commission and are applied by the pipeline fairly to all similarly-situated shippers and shipments." 102/ Our regulations so provide. 103/ Also, in Order No. 436, we considered the question of whether it was discriminatory for a pipeline to refuse transportation to a customer in bankruptcy proceedings. There, we determined that it might be appropriate for a pipeline to propose special prepayment arrangements in its tariff for such a customer. 104/ In Texas Eastern, we found that such a tariff provision was permissible. We made one exception in Texas Eastern, however, that is applicable here as well. We held that Texas Eastern could not simply abandon service to a non-credit worthy shipper without specifically applying for authorization to terminate service. 105/ We shall make the same proviso here. With respect to Fina's request that the shipper should be permitted to elect whether to make the prepayment or post the bond or other security, we believe the tariff provision gives the shipper that right. With respect to Citizens' statement that Transco should not have the right to refuse service where advance payment is made, we agree. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to clarify this provision.

2. Balancing and Penalty Provisions: Section 5.7 of Rate Schedule FT and section 4.5 of Rate Schedule IT, as well as section 18.4 of the General Terms and Conditions impose penalties on shippers for unauthorized overruns and for failure to correct imbalances. Various concerns have been raised by the commenters with respect to the penalty provisions. We shall address them in turn.

As we noted above, Order No. 436 provided that pipelines may impose "reasonable operating and load management conditions" (such as balancing penalties) so long as the pipeline stated the conditions "up-front" in its tariff and applied them fairly to

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102/ Order No. 436 at 31,505.

103/ 18 C.F.R. § 284.8(c) and § 284.9(c) (1986).

104/ Order No. 436 at 31,505.

105/ Texas Eastern, slip op. at 55.

all similarly situated shippers. 106/ In El Paso and in Texas Eastern, we found the assessment of penalties to be a reasonable means of deterring conduct that may adversely affect the efficient operation of the pipeline's system. 107/ In a perfect world, the volumes nominated by the pipeline's customers and the amount of gas injected into the system to meet those nominations, whether for sales or transportation, will match the amount of gas taken out of the system on a given day. But, for various reasons, whether due to a shipper taking an amount of gas which exceeds its daily entitlement, or injecting more gas into the system than it takes out, the balance does not always hold. The imbalances created in these situations can cause harm to other customers and potential shippers on the system and to the operation of the pipeline.

Transco's tariff provides for two types of penalties. The first is for imbalances which are addressed in sections 4.3 and 5.5 of Rate Schedules IT and FT, respectively. The second type of penalty covers overruns and is provided for in section 18 of the General Terms and Conditions. Sections 4.3 and 5.5 of Rate Schedules IT and FT, respectively, require imbalances to be corrected as soon as practicable, but no later than during the calendar month following written notification of such imbalance. There is no penalty imposed for failure to correct an imbalance within that time period. Commenters have argued that even though the calendar month period commences from the date of written notification from Transco of the imbalance, the time is not adequate. 108/ We agree. In El Paso, we found 45 days to be an appropriate length of time in which to correct a monthly imbalance. 109/ We shall impose the same condition here, and shall require that the settlement be modified accordingly.

Section 4.5 of Rate Schedule IT and section 5.7 of Rate Schedule FT provide for an assessment of a penalty if an imbalance remaining in favor of a shipper exists when deliveries cease. The provision provides that if such imbalance is not eliminated within 60 days after written notification from Transco, the shipper shall pay Transco a penalty of $10 per dt for such imbalance quantities, or

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106/ Order No. 436 at 31,505.

107/ See El Paso, 35 FERC at 62,066-70; Texas Eastern, slip op. at 55-66.

108/ Initial Comments of American Paper at 2; Initial Comments of Cheney at 5.

109/ El Paso, 35 FERC at 62,068.

whatever other penalty may be provided in section 18.6 of the General Terms and Conditions (Unauthorized Overruns During Periods of Curtailment).

The objection raised here is to the amount of the penalty. API, PMTG, and Pina argue that the $10 per dt penalty is too severe. We agree. This penalty only applies when the quantity the shipper takes from Transco exceeds the shipper's nominations. In El Paso, we found that a reasonable penalty in this situation was two times the commodity charge in the firm sales rate schedule. 110/ We shall apply that penalty here, as well. Sections 4.5 and 5.7 do not provide for a penalty in the situation where the shipper delivers to Transco a quantity of gas that exceeds the quantity of gas the shipper takes from Transco. We believe that a penalty should be imposed in that situation and that, as in El Paso, the penalty should be that Transco will retain at no cost the excess gas. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to provide, in section 4.5 of Rate Schedule IT and section 5.7 of Rate Schedule FT, that if an imbalance is not corrected within 60 days after notification that an imbalance exists, the following penalties shall be imposed: (1) if the quantity the shipper takes from Transco exceeds the shipper's deliveries, the penalty shall be two times the commodity charge in the firm sales rate schedule; (2) in the event the shipper delivers to Transco more gas than it takes, the penalty shall be that Transco will retain at no cost the excess gas.

One further matter deserves our attention. Both sections 5.7 and 4.5 state that they apply when an imbalance exists "when quantities cease to be delivered." It is unclear whether that means when the contract ceases or whether it applies if deliveries cease for some other reason. We shall require that Transco clarify that point when it refiles its revised tariff sheets as we have required.

The second type of penalty imposed by Transco is for unauthorized overruns. These penalties are found in section 18 of the General Terms and Conditions. Section 18.2 sets forth the allowable daily dispatching variations which on any given day shall be the greater of 50 dt or a quantity ranging from 2.5 percent to 5 percent of buyer's maximum daily delivery obligation for the period May 1 through September 30 and 3.5 percent for the period October 1 through April 30. An unauthorized daily overrun is defined as a quantity in excess of buyer's maximum daily delivery obligation under the rate schedules listed in section 18.3. The penalties

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110/ El Paso, 35 FERC at 62,066.

which attach are set forth in section 18.4 of Transco's tariff. The penalties are as follows: a penalty of $2.50 per dt up to 50 dt, $10 per dt for the balance, if any of the unauthorized daily overrun quantity, up to the quantity specified in section 18.2 as allowable variation for that particular day, and a penalty of $25 per dt for any quantity of additional unauthorized daily overrun taken on such day.

Section 18.5 provides that the penalty payment provided in section 18.4, described above, will not apply when any of three conditions have been met:

(1) when the unauthorized daily overrun quantity does not exceed the allowable variation; or

(2) if the overrun is caused by failure of measuring, including telemetering equipment or by breakage of shipper's facilities, provided the shipper advises Transco immediately and completes the repair with due diligence; or

(3) if the shipper on the day immediately following notice of an unauthorized daily overrun otherwise subject to a penalty, balances out the overrun by scheduling and taking gas from Transco.

Commenters have objected to several aspects of the overrun penalty provisions: (1) the time provided for correcting an imbalance; (2) the variations permitted; and (3) the amount of the penalty. API, the Indicated Producers, and the PMTG object to all three. Fina argues that the dollar amount of the penalties is too severe; Cheney states that the one day allowed to cure daily overruns is insufficient. We agree with the concerns raised by many of the commenters and we shall modify the settlement accordingly.

We agree that the one day period provided to correct daily overruns is inadequate. In El Paso, we found that two days for the shipper to end the overrun, on a prospective basis, was appropriate. We believe that the time period established in El Paso is reasonable and applicable here as well. Accordingly, we shall condition our acceptance of the settlement on Transco filing revised tariff sheets to reflect these changes.

Commenters also raise concerns with respect to the amount of the allowable daily variations. As we noted above, a penalty will not be assessed if the daily overrun is the greater of 50 dt or 5 percent of buyer's maximum daily delivery obligation (during the period May 1 through September 30) or 3.5 percent (during the period October 1 through April 30). American Paper argues that the

percentages of permitted daily variations are inadequate. For example, they argue, a variation between injections and takes from a pipeline can vary widely due to an unexpected breakdown of gas-fired equipment used at the shipper's plant. Thus, American Paper urges that a 10 percent variation would accommodate variations in gas usages while still encouraging gas users to keep daily variations to a minimum. 111/ Indicated Producers agree that a 10 percent variation should be permitted, arguing that it is unjust and unreasonable to impose penalties on a shipper when the variation in his deliveries is less than normally occurs in the pipeline through meter errors, line losses, and line pack. 112/

We agree that the variations permitted by Transco are inadequate and we shall adopt the commenters' suggestion that a 10 percent variation be applied. Transco's justification for the variation percentages is merely that they represent basically the same operating conditions which have been in effect on the system for many years. We think this reason is insufficient. 113/ Accordingly, we shall adopt American Paper's and the Indicated Producers' suggestion and find that a 10 percent variation is reasonable.

With that, we turn to the penalties themselves. Many of the commenters argue that the level of the penalties is too high. Both American Paper and the Producer-Marketer Group argue that the penalties are excessive and that the Commission should find that they are not cost-based. Producer-Marketer Group argues that the penalty should not exceed a level that would compensate Transco for lost revenues due to excess deliveries. Further, the Producer-Marketer Group argues that the penalty should apply only when there is no excess capacity on Transco's system. 114/

We agree that the level of the penalties is too high. However, we do not make this finding on the basis that the penalties are not cost-based. As we stated in El Paso, the penalties are not intended to compensate the pipeline for the costs it incurs when a shipper overdelivers. "The penalties are intended to deter conduct that adversely affects the efficient operation of [the pipeline's]

111/ Initial Comments of American Paper at 4.

112/ Initial Comments of Indicated Producers at 13.

113/ See Texas Eastern, slip op. at 62.

114/ Initial Comments of Producer-Marketer Transportation Group at 6.

system." 115/ Transco's justification for the amount of the penalties is the same it offered in support of the tolerance variations it established -- what was good enough in the past should be good enough for the present. Transco states that the charges are consistent with similar charges which have been previously approved by the Commission for Transco's tariff. Transco notes that the maximum daily overrun charges in section 18 have already been approved by the Commission and are applicable to Transco's existing firm sales and transportation services. In Texas Eastern, we found that reasoning insufficient to justify the penalties proposed there. 116/ We see no reason to reach a different result here.

We are, of course, aware that most pipelines' tariffs contain an overrun penalty. Many of them are set at amounts ranging from $10 to $25 per dt. But, as we noted in Texas Eastern, those overrun penalties were established during a period of gas shortage when pipelines were forced to preserve their gas supply for high priority usage. An overrun in those circumstances could lead to curtailment of service for high priority use. Accordingly, we found that the harm caused by overruns in the present situation do not compel the same result. We held that the punishment should fit the crime, and that the overrun penalty for firm transportation should be lower than the overrun penalty for sales. 117/ The rationale applied in Texas Eastern is applicable here as well.

We noted in Texas Eastern that in implementing the open access provisions of Order No. 436, we were embarking on relatively new territory and although we agreed it was necessary to deter shippers from engaging in harmful conduct, we did not wish to deter so well as to discourage the transportation that is at the heart of the program. Thus, we found it reasonable to establish a low overrun penalty now and if experience should prove it to be inadequate, the penalty could be increased at a later time. 118/

115/ El Paso, 35 FERC at 62,067.

116/ Texas Eastern, slip op. at 60.

117/ Texas Eastern, slip op. at 61.

118/ Id.

Here, the Producer-Marketer Group suggests that the overrun penalty be established at a level equal to 200 percent of the CD Rate Schedule commodity rate for the applicable zone. Fina, on the other hand, recommends a fee of $5.00 per dt as a sufficient deterrent to prevent conduct resulting in imbalances. Fina also states that imbalance penalties should be levied uniformly by Transco against all shippers, including Transco's affiliate, TEMCO, and that all such penalties should be credited to Account No. 191.

As we discussed above, in El Paso, we found that where the shipper delivers to the pipeline a quantity of gas that exceeds the maximum daily quantity by more than 10 percent or 50 dt, whichever is greater, the penalty is that the pipeline will retain at no cost the excess gas. In the reverse situation, where the quantity of gas the shipper takes from the pipeline exceeds by 10 percent or 50 dt, whichever is greater, the quantity delivered to the pipeline, we found that a reasonable penalty is two times the commodity charge in the firm sales rate schedule. We shall apply these penalties here as well.

With respect to Fina's contention that the penalties should be levied uniformly against all shippers, including TEMCO, we believe that Transco's proposed tariff language is not to the contrary. There is no indication that Transco will not apply the penalties uniformly. Fina has also suggested that all penalties should be credited to Account No. 191. Transco has not proposed that any revenues received from penalties should be credited to Account No. 191. In El Paso, supra, we rejected a similar proposal. 119/ There are several problems inherent in such a crediting mechanism. One is simply that the revenues generated by penalties are not purchased gas costs. Secondly, only Transco's sales customers would reap the benefit of such a credit. In El Paso, we stated that if the penalties are properly designed, there will be no revenue to credit. If the penalties do generate revenue, we held that this fact could be taken into consideration in the pipeline's next rate case. Thus, we shall reject Fina's request that revenues be credited to Account No. 191.

Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets in accordance with the discussion above. The daily penalty as well as the penalty to be assessed for failure to correct an over delivery in the shipper's favor within 60 days after the termination of the transportation agreement is the retention by Transco of the excess gas at no cost and free and clear of any adverse claims. Excess gas is gas

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119/ El Paso, 35 FERC at 62,070.

delivered by the shipper that exceeds the shipper's MDTQ by the greater of 50 dt or 10 percent. The penalty to be imposed in the situation where the shipper's takes exceed by 10 percent or 50 dt, whichever is greater, the amount delivered by the shipper to Transco, shall be two times the commodity charge in the CD Rate Schedule.

3. Points of Receipt: Section 5 of Rate Schedule FT and section 4 of Rate Schedule IT address the subject of receipt and delivery points. Section 5.2 of Rate Schedule FT provides that the points of receipt at which Transco shall receive gas for firm transportation shall be set forth in the executed service agreement. For each point of receipt identified in the service agreement, there shall also be identified Transco's Daily Receipt Obligation (DRO). Section 4.1 of Rate Schedule IT also provides that the points of receipt shall be identified in the executed service agreement for interruptible service. Section 5.2 of Rate Schedule FT and section 4.1 of Rate Schedule IT provide for shippers to change receipt and delivery points. Under Rate Schedule FT, the shipper can add or delete points of receipt and request changes in the shipper's DRO upon 30 days written notice to Transco. Transco makes one proviso however. That is that it shall not be required to accept a change if it would "impair Seller's ability to meet its firm obligations under existing service agreements or would limit Seller's ability to meet its obligations with current or anticipated suppliers." Section 4.1 of Rate Schedule IT provides that upon written notice (there is no 30-day requirement), the shipper may add or delete receipt and delivery points. Transco's acceptance of such requests is subject to the requirements of its blanket certificate under section 7(c) and Part 284 of the regulations.

The significance of any change in receipt or delivery points is that it raises the question of whether the change will be considered a new transaction for purposes of determining capacity allocations under the first-come, first-served scheme. Our regulations provide that a pipeline may at the shipper's request and without prior notice, change receipt points and, to a lesser degree, delivery points. 120/ This, however, does not address the issue of the relationship between flexibility in receipt and delivery points and the requirements of the first-come, first-served rule.

These provisions have provoked comment from several parties. American Paper objects to the 30-day notice firm shippers must give before they may change receipt points and requests that the requirement be eliminated. In addition, American Paper argues

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120/ 18 C.F.R. § 284.221(g) and § 284.221(h). See also, Order No. 436 at 31,550.

that shippers should be permitted to change gas receipt points without such changes being considered "new" transportation arrangements under first-come, first-served. This flexibility is needed, API argues, because a shipper may be required to change a receipt point during the term of a transportation contract for a number of reasons, including a problem encountered by shipper's gas supplier with a particular well connected to Transco's system, or simply because the shipper might want to change gas suppliers because of price considerations. Similarly, API argues, shippers should have the flexibility to change a delivery point without jeopardizing the shipper's priority of service. For example, API states, a shipper might want to change a delivery point to accommodate transportation of the gas to a different end-user location or to facilitate a more competitive arrangement for downstream transportation of the gas after it leaves the pipeline's system. API also asks the Commission to clarify that a shipper may be permitted to renew or extend the term of its transportation contract with Transco without the contract renewal or extension being considered a "new" arrangement. 121/

Citizens Energy argues that customers should be able to make a blanket designation of delivery points in their service agreements. Such a blanket provision would have the advantage, according to Citizens, of permitting a free movement of gas, and would permit customers to satisfy their minimum obligations to Transco through whatever flexible arrangements they can devise. Owens-Corning does not object to the provision but states that the language "anticipated suppliers" is too broad and asks us to exclude that portion of section 5.2 of Rate Schedule FT.

Fina objects to that portion of section 5.2 which permits the changes in receipt and delivery points. Fina argues that the provision is inconsistent with the first-come, first-served requirement of Order No. 436. Fina states that if additional firm capacity becomes available at some location on Transco's system, eligible firm shippers waiting in line for such service should be afforded the opportunity to use that incremental capacity. Additionally, Fina argues that allowing an existing shipper to have a priority claim on that capacity will favor Transco's affiliates who, Fina avers, already have Transco's non-sales transmission capacity monopolized.

121/ Initial Comments of API at 5-8; Initial Comments of Citizens Energy at 9-10; Initial Comments of Owens-Corning at 9-10.

It is not entirely clear from Transco's proposed tariff language whether the changes permitted will be considered new transportation arrangements within the first-come, first-served allocation scheme. In El Paso, we noted that pipelines may permit shippers to amend their arrangements to add receipt points without the amendment being considered a new transaction. 122/ We shall require Transco to file revised tariff language to clearly state its policy on this issue. If the policy is to permit amendments without having an amendment be treated as new service, we shall also require Transco to file tariff provisions that state how changes in receipt points will affect priority. In Texas Eastern, we suggested some questions which such a provision must address:

> For example, suppose Shipper I is the first in line. It delivers its gas at Receipt Point A. Shipper II is the second in line. It delivers its gas at Receipt Point B. If Shipper I now wants to deliver its gas at Receipt Point B and Shipper II is using its full entitlement to the capacity of Receipt Point B, will Shipper II be denied service? If Shipper II is not using its full entitlement, will it be precluded from using its full entitlement again? If the capacity of Receipt Point B is such that both Shipper I and Shipper II may deliver gas there, what happens when capacity at the Receipt Point is constrained? Will Shipper I have priority because it is first in line? Or will Shipper II have priority because it is first in line for service at Receipt Point B? Moreover, what happens if Shipper III has requested service at Receipt Point B after Shipper II but before Shipper I? Will Shipper III be denied service? 123/

We do not believe the same degree of flexibility should be extended to delivery points. This is so because it is inconsistent with the first-come, first-served principle. In El Paso, we held that delivery point flexibility "while retaining a shipper's same priority in the first come/first served queue, is inconsistent with our requirement for identification of the ultimate recipient in each transaction. If each contract must be specific to an end-user, all necessary delivery points can easily be named in the

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122/ El Paso, 35 FERC at 62,066.

123/ Texas Eastern, slip op. at 68, fn. 141. See also El Paso Natural Gas Co., Order Denying Rehearing and Granting Clarification, 38 FERC ¶ 61,008 (1987), slip op. at 24.

contract." 124/ We note that Transco's tariff does provide certain flexibility in that the shipper is allowed to name multiple receipt and delivery points when the shipper contracts for transportation service and executes the required service agreement.

We reject API's and Citizens' contentions that shippers should have blanket authority to change receipt and/or delivery points whenever they choose to do so. Such blanket authority would render the first-come, first-served principle meaningless. Fina's suggestion, at the other extreme, would permit no flexibility. This is too severe and is not required by Order No. 436. With respect to Fina's allegations regarding Transco's affiliates, they are sufficiently vague to make it difficult to address them. The requirements of this order cover affiliates as well as other transportation customers. We shall, however, address certain questions relating to Transco's affiliates in a separate section, infra.

One other point merits attention. Transco has reserved the right, in section 5.2, to reject requests for changes in receipt points if such changes would impair Transco's ability to meet its firm obligations under existing service agreements or would limit Transco's ability to meet its obligations with current or "anticipated suppliers." It is the last, quoted portion of that provision that troubles one commenter, Owens-Corning. It is troubling to us as well.

In Texas Eastern, we discussed a similar provision in Texas Eastern's tariff which provided for acceptance of a change in receipt point unless it determined that acceptance of the change would impair its ability to receive gas into its system to satisfy its sales obligations under contracts effective at the date the shipper requested the service or that Texas Eastern reasonably expects to be effective within six months. 125/ There, we found the provision acceptable, stating that it is reasonable for a pipeline in evaluating a request for firm transportation, to consider its plans to provide firm sales on a least-cost basis. We found the six months reasonable although we stated that a pipeline may not deny a request for firm transportation based on an expectation that it may need the capacity at a distant future date. 126/ Here, we think the term "anticipated suppliers" is too vague and confers a right upon Transco to be speculative rather than judicious in

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124/ El Paso, 35 FERC at 62,066.

125/ Texas Eastern, slip op. at 70.

126/ Id.

making its capacity determinations. Accordingly, we shall require that Transco either limit the provision by assigning a reasonable time limit or delete it.

Staff and Elizabethtown Gas Company have raised another issue with respect to section 5 of Rate Schedule FT. Section 5.3 provides that Transco's DRO under section 1.1(a)(i) of Rate Schedule FT may be reduced from time to time in order to permit Transco to receive gas into its system to satisfy its obligations under its firm sales and transportation rate schedules, or to satisfy its obligation to receive gas for other Section 1.1(a)(i) transportation agreements. Section 1.1(a)(i) refers to shippers that have elected to receive standby sales service and have conditionally converted to firm transportation as provided in Rate Schedule MDQ. In other words, Transco has reserved the right to reduce its DRO with respect to standby customers so that it may receive gas to satisfy other sales obligations or to receive gas for delivery by other standby customers. Elizabethtown argues that the inclusion of section 5.3 in the FT Rate Schedule seemingly turns firm transportation service under subsection 1.1(a)(i) into a second rate transportation service. Staff contends that the effect of section 5.3 is inconsistent with Order No. 436 because it results in certain firm transportation service becoming less than firm, and thus inferior to other FT or sales service. 127/

We agree. Firm transportation is required to be just that -- firm. The requirement of section 5.3 would render firm transportation for standby customers something less. 128/ Staff notes that because the receipt points for accepting FT conditional conversion gas may be the same points where gas for sales or other firm transportation enters Transco's system, uncertainties may arise as to how much capacity is available in order to offer firm transportation under conditional conversion. However, staff argues that these types of capacity constraint on Transco's system should be determined at the time service is requested. We addressed the identical issue in Texas Eastern. We there found that the appropriate remedy was to modify that section of the tariff to ensure that the service the standby customer receives under Rate Schedule FT will be on a firm

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127/ Initial Comments of Elizabethtown at 18-22; Initial Comments of Staff at 7-9.

128/ See 18 C.F.R. § 284.8(a)(3), defining firm transportation service as service not subject to a prior claim by another customer or another class of customer.

basis. 129/ We believe the same result is required here and, accordingly, we shall condition our approval of the settlement on Transco filing revised tariff language to eliminate section 5.3. 130/

B.

General Terms and Conditions

Allocation of Capacity: Section 27 of the General Terms and Conditions addresses the issue of allocation of Transco's capacity among firm and interruptible services. Section 27.1 sets forth a monthly chronology Transco will follow in determining the availability of capacity on its system. On the 10th of each month Transco will provide a list of anticipated delivered prices to shippers. Then, no later than the 15th of each month, the shippers will furnish Transco with estimates of their requirements for the upcoming month under all firm and interruptible transportation rate schedules. On the 20th day of the month Transco will advise each shipper of the anticipated availability of capacity corresponding to the shipper's request. To the extent capacity constraints require Transco to allocate capacity among shippers requesting service, Transco will reflect this allocation in its response. If the requested transportation service is reduced, the shipper will have a further opportunity, no later than five (5) days prior to the end of the month to nominate additional transportation quantities. Finally, no later than one day prior to the end of each month, Transco will establish and communicate to the shippers the various levels of service anticipated to be provided beginning on the first day of the next month.

Next, in section 27.2, Transco sets forth the order of priority for allocating available capacity when in determining its monthly capacity available to satisfy requests for service, Transco determines that such allocation is necessary. First, section 27.2(c) provides that if Transco is required to allocate capacity on its system it shall first give priority to firm sales and firm transportation services. This provision is fairly simple and has not provoked any opposition from commenters. Next, however, section 27.2(c) describes the allocation of capacity for interruptible customers. This provision is opposed by several commenters.

129/ Texas Eastern, slip op. at 67-69.

130/ In its Reply Comments, Transco states that it is willing to accept an order approving the settlement without the so-called "second class" FT service. Reply Comments at 21.

Section 27.2(c) provides that to the extent capacity remains after allocation to firm sales and transportation services, it will be allocated to interruptible services in the following manner:

> (i) first, to Buyers requesting service in excess of their respective contract entitlements under the CD, MDQ, G, OG or FT Rate Schedules and firm direct industrial contract, for (1) withdrawals under the WSS Rate Schedule, and (2) gas transported under existing certificated transportation arrangements as set forth on Appendix D to the Stipulation and Agreement . . . . To the extent that insufficient capacity is available on any day to transport WSS withdrawals in excess of the Buyer's firm sales and FT contract entitlements and the certificated transportation quantities listed on such Appendix D in excess of the Buyer's firm sales and FT contract entitlements, the available capacity shall be allocated on the basis of each customer's total of such certificated transportation contract maximum daily quantities and its proportionate share of the daily delivery capability of the Washington Storage Field to aggregate total of such certificated contract maximum daily quantities and the total daily delivery capability of the Washington Storage Field;
>
> (ii) then, ratably to Buyers under all other pre-existing contracts, service agreements, or certificates (effective as of October 9, 1985); and
>
> (iii) then, ratably to any remaining Buyers under the IT Rate Schedule. 131/

Several commenters argue that this provision conflicts with the first-come, first-served principle of Order No. 436. Transco states that capacity will be allocated on a pro rata basis. Pina argues that allocating capacity for interruptible transportation on a ratable basis flatly contradicts the provisions of Order No. 436. Rather, Pina submits, under the first-come, first-served principle for allocating capacity, the only appropriate method for allocating interruptible transportation capacity would be on a first-come, first-served basis. We agree.

131/ Section 27.2, General Terms and Conditions.

In Order No. 436-A, several commenters suggested that pipelines should be allowed to use other just and reasonable methods of allocating capacity and should not be required to allocate on a first-come, first-served basis. We answered that contention as follows:

> The first-come, first-served method ensures that capacity will be allocated on a non-discriminatory basis . . . While other methods of allocating capacity could be devised, the requirement that all pipelines operate on the first-come, first-served principle ensures that they all stand on an equal footing in obtaining customers and their customers stand on an equal footing in obtaining service. 132/

API argues that section 27.2(c)(i) gives first priority to certain of Transco's sales and firm transportation customers also seeking interruptible transportation. These provisions are unduly discriminatory, API avers, for the reason that existing sales and transportation customers seeking new interruptible transportation service from Transco cannot be permitted to leap ahead of existing interruptible transportation customers. API asserts that this plainly violates the first-come, first-served principle. 133/ In a similar vein, Indicated Producers argue that section 27.2(c) gives priority to interruptible sales service over interruptible transportation service, in violation of Order No. 436. Indicated Producers state that once priorities have been established among classes of service, then all customers within the same class should be included in the allocation process without preference to any group or sub-class of customers. Allied takes a similar tack in arguing that a priority should not be given to existing certificated transportation arrangements and firm sales customers for withdrawals under the WSS Rate Schedule as provided in section 27.2(c)(i). Rather, Allied asserts that the first two classes (section 27.2(c)(i) and section 27.2(c)(ii)) should be grouped together for priority purposes since they are all existing transportation arrangements.

Basically, we agree with the thrust of the commenters' arguments. As we stated above, interruptible capacity must be allocated on a first-come, first-served basis. We also agree that the priority scheme established by Transco for interruptible services gives an

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132/ Order No. 436-A at 31,684.

133/ Initial Comments of API at 11. See also Initial Comments of Allied at 8; Initial Comments of Indicated Producers at 7.

undue preference to existing sales and firm transportation customers of Transco who seek new interruptible transportation. API has hit the nail squarely on the head when it asserts that those customers cannot leap ahead of existing interruptible customers. Transco's rationale for first providing service to existing customers requesting WSS withdrawals is that it historically has been Transco's practice to provide such service before performing other interruptible transportation services. Transco states that it relies upon the language of Order No. 436 that preserves existing contractual and capacity allocation procedures to the extent possible. We assume the language Transco refers to is that found in Order No. 436-A, where the Commission stated that "if capacity is insufficient to meet demand, the final rule allows pipelines to allocate the limited capacity of their systems among their firm and interruptible customers . . . on the same basis that they allocated capacity prior to the rule." 134/ Transco argues that this language supports the preference it has bestowed in section 27.2(c)(i).

We addressed a similar question in Texas Eastern when we discussed that pipeline's scheme for allocating interruptible capacity. There, Texas Eastern assigned a lower priority to self-implementing interruptible transportation than that accorded to other types of interruptible transportation. One commenter argued that the language quoted above supported the preference. The Commission disagreed, declaring that the idea conveyed by the statement on which the commenter relied is simply that the first-come, first-served scheme of allocating capacity does not require pipelines to curtail on a last-on, first-off basis. "The point of the statement was certainly not to permit pipelines to continue existing curtailment plans that unduly discriminate against self-implementing transportation." 135/

We find this logic applicable here as well. We cannot permit Transco to allocate priority on the basis of historical practice if that allocation conflicts with the requisites of Order No. 436 and discriminates against other interruptible services provided by the pipeline. We think that the allocation scheme proposed by Transco would have just that effect.

Indicated Producers contend that there should be no distinction among customers within the interruptible class. Allied, on the other hand, would group together the customers referenced in section 27.2(c)(i) and 27.2(c)(ii) for priority purposes. We agree that the priority scheme must be restructured but not exactly as these commenters have proposed. There are several reasons for our decision.

134/ See Order No. 436-A at 31,653.

135/ Texas Eastern, slip op. at 74, fn. 151.

In El Paso, we approved an allocation method that made one distinction in the priority scheme. El Paso's allocation scheme provided that if capacity was inadequate to serve all the requests made, it would schedule nominations by firm sales and transportation customers on a pro rata basis. Next, it would schedule volumes nominated by interruptible customers first to customers that contracted for interruptible transportation prior to October 9, 1985, and second to the customers that contracted for interruptible transportation after October 9, 1985. 136/ We found that to be a valid distinction since Order No. 436-A gave a higher priority, in the first-come, first-served scheme, to existing interruptible transportation customers. 137/

The allocation plan proposed by Transco, however, far exceeds the bounds of what the Commission approved in El Paso. Furthermore, we think it is unnecessarily confusing. We will approve giving priority status, as Transco has done in section 27.2(c)(ii) to "buyers under pre-existing contracts, service agreements or certificates effective as of October 9, 1985" and then, as provided in section 27.2(c)(iii), "to any remaining Buyers under the IT Rate Schedule," but not "ratably". As discussed above, capacity is to be allocated on a first-come, first served basis. Section 27.2(c)(1) gives cause for concern. We find that the priority given to "Buyers requesting service in excess of their respective contract entitlements" under the rate schedules listed for withdrawals under the WSS Rate Schedule and gas transported under the existing certificated arrangements set forth on Appendix D conflicts with the first-come, first-served rule of Order No. 436. Transco should serve contractual arrangements first, then excess service. Transco has supplied no other reason for this priority than the fact that it is based on historical practice. We do not find that reason compelling, as we discussed above. Indeed, under the priority scheme required by Order No. 436, the requests for service listed in section 27.2 (c)(i) should go to the end of the line, behind what we have found reasonable in section 27.2(c)(ii) and 27.2(c)(iii). We remain puzzled, however, by the separate distinction that is made for the "existing certificated transportation arrangements" listed on Appendix D to the settlement. Transco has supplied no reason those agreements should be treated differently from other existing agreements, namely those described in section 27.2(c)(ii). If none exists, then we believe it is proper for those agreements to be included with those described in section 27.2(c)(ii) for priority purposes. One commenter, Citizens, alleges that the agreements are

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136/ El Paso, 35 FERC at 62,060-61.

137/ Id.

comprised in large part of grandfathered agreements supplied by or with TEMCO, Transco's marketing affiliate, and a preference should not be given to those types of arrangements. Citizens has not really made any specific allegation that we can address. If some of Transco's existing agreements are with its affiliate, TEMCO, they will be accorded no greater priority than other existing arrangements. And we have determined that any agreement existing as of October 9, 1985, is given priority over other requests for interruptible service. We do not think there is a problem.

Another commenter, Lynchburg Gas Company (Lynchburg) raises an objection to the existing arrangements identified on Appendix D. Lynchburg contends that the list is drawn too narrowly and that other existing interruptible transportation arrangements under self-implementing authority should be afforded the same priority. Lynchburg states that the mere fact that an interruptible service is certificated rather than implemented under section 311 of the NGPA is irrelevant. We agree. This objection is really no different than that raised by Indicated Producers. As we discussed above, we agree that there should not be a distinction between existing interruptible transportation arrangements.

Lynchburg also makes the argument that this priority should be expanded to include all self-implementing or certificated interruptible transportation arrangements in existence as of March 28, 1986, the date on which Transco originally filed its settlement. Lynchburg provides no reason why this should be so other than it is the date the settlement was first filed.

As we stated above, we found the pre-October 9, 1985 and post-October 9, 1985 dates to be reasonable in El Paso. Transco has proposed the same distinction here. We do not find that Lynchburg has presented any argument that would persuade us to extend that date. There is no evidence in the record to support such a change. Accordingly, we reject Lynchburg's suggestion that we change the October 9, 1985 date.

For the reasons discussed above, we find that the allocation priority established by Transco does not comport with the first-come, first-served requirements of Order No. 436. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to establish a proper allocation method for interruptible service. We shall also require Transco to clarify the distinction it has made for the existing transportation arrangements listed on Appendix D.

Pursuant to our finding that the allocation priority established by Transco is not consistent with the first-come, first-served principle, we note that the monthly chronology established by

Transco may require modification in light of that finding. The monthly chronology, as we discussed above, is set forth in section 27.1 of the General Terms and Conditions of Transco's tariff. Accordingly, we shall require that Transco modify this section to be consistent with the changes we have required in the capacity allocation scheme.

One other provision of section 27 merits discussion. Section 27.2(d) states that any buyer not paying the maximum rate may be interrupted first unless willing to pay the maximum rate for the period of capacity allocation. 138/ Both API and the Indicated Producers object to this provision. API argues that it is unduly discriminatory. API states that to the extent a pipeline offers a transportation customer a permissible discount below the maximum rate, it should not be allowed to revoke the discount in times of capacity shortages. Indicated Producers argues that the provision is counter to the first-come, first-served requirement since Transco proposes to first curtail service if a shipper is paying less than the maximum rate.

We disagree. Selective discounting is offered at the discretion of the pipeline. It does not confer an undue preference on the shipper receiving the discount. In Order No. 436-A, the Commission stated:

> The Commission notes, however, that a pipeline is never required to accept a request for service by a customer if that customer has not indicated a willingness to pay the maximum rate. Selective discounting is totally at the discretion of the pipeline. . . . Parties may nevertheless agree to make such interruptible service subject to another customer coming in at a later point willing to pay a higher rate than the discounted rate determined between the pipeline and the first customer. (Emphasis supplied). 139/

138/ We assume that this provision applies only to the allocation of capacity for interruptible transportation. It would not be appropriate for firm transportation.

139/ Order No. 436-A at 31,685.

All section 27.2(d) does is give Transco that right -- to interrupt a customer not paying the maximum rate. We think that is a matter within Transco's discretion. The customer has the right to pay the maximum rate and avoid interruption of service. We think that this is a reasonable provision and that it in no way conflicts with the first-come, first-served rule. 140/

Section 27.2(f) contains a use-or-lose provision which has invited comment. We have discussed that provision above, however, in our consideration of Transco's operating conditions. (See supra at p. 37-38).

Curtailment Procedures: Section 11 of the General Terms and Conditions of Transco's tariff sets out procedures for daily curtailments for force majeure or operating conditions that provide for curtailment. Section 11.2 provides for curtailment in the following order: (1) all interruptible sales and transportation on a ratable basis; (2) firm transportation services under Rate Schedules X-11, X-42, X-52 and X-56 on a ratable basis; and (3) all remaining firm transportation and sales on a ratable basis.

Staff takes issue with this provision. Staff argues that treating categories of firm service differently for curtailment purposes is inconsistent with Order No. 436. We agree. In Order No. 436 we stated that "once a customer has contracted for, or booked, a pipeline's firm capacity under this rule, that customer will be entitled to the same firm service as any other firm customer since it is guaranteed that capacity is available." 141/ Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to provide for curtailment of all firm services on a pro rata basis.

C.
Transportation Rates

The settlement establishes the rates Transco will charge for firm and interruptible self-implementing transportation under Rate Schedule FT and Rate Schedule IT, respectively. Article IV, section 3 of the settlement provides that the transportation rates are based on the costs established in Docket No. RP83-137-000, Transco's last major rate case. Article IV also states that the transportation

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140/ See also Northern Natural Gas Co., Order Approving Contested Offer of Settlement As Modified, 37 FERC ¶ 61,272 (1986), slip op. at 26-27.

141/ Order No. 436 at 31,517.

rates comply with the Commission's rules and regulations under Order No. 436. We shall consider the firm and interruptible rates separately in the discussion which follows.

Interruptible Rates: Article VI of the settlement provides that the rates that Transco may charge for interruptible transportation are subject to the Commission's final determination of issues reserved for hearing in Docket No. RP83-137-000. That proceeding was initiated on September 30, 1983, when Transco filed for a rate increase pursuant to section 4 of the NGA. The Commission accepted Transco's filing and suspended its effectiveness for five months, until April 1, 1984, subject to refund thereafter. 142/ On July 25, 1984, a settlement was approved by the Commission which resolved, inter alia, cost of service, sales rate design, and representative cost and throughput levels for Transco's system. 143/ Article III of that settlement reserved for hearing and disposition issues related to Transco's interruptible transportation service, which included the terms and conditions of service and proper fuel retention levels. An evidentiary hearing was held in the reserved docket. An initial decision was issued on November 8, 1985. 144/ That initial decision is pending before the Commission on exceptions. The specific issues to be resolved there include whether the interruptible rates will be based on the 100 percent load factor allocation of costs, the proper fuel retention levels, and whether costs associated with transportation and compression by others (Account No. 858 costs), prepayment costs, advance payments, and storage costs shall be included in Transco's interruptible transportation rates.

By the terms of the settlement before us, Transco proposes to charge interruptible transportation rates that are based on the volumetric equivalent of the firm transportation rate computed at 100 percent load factor level, pending the outcome of the Commission's final determination in Docket No. RP83-137-011. Several commenters object to deferring resolution of these issues until the Commission issues a final order in RP83-137-011.

Indicated Producers and Fina argue that the record in Docket No. RP83-137-011 did not include Order No. 436 issues, that they were not parties to that proceeding, and would be unable to file briefs in that proceeding at this late date. Cheney recommends

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142/ 25 FERC ¶ 61,144 (1983).

143/ 28 FERC ¶ 61,146 (1984).

144/ 33 FERC ¶ 63,035 (1985).

that the Commission go beyond the "antiquated record" in that proceeding and take action to either allow additional comments or to reconcile that docket with Order No. 436. 145/

We agree that the commenters have raised legitimate concerns with this provision of the settlement. The hearing in Docket No. RP83-137-011 concluded on March 5, 1985, and the administrative law judge's decision was issued on November 8, 1985. 146/ The issues in that proceeding were litigated before issuance of the Notice of Proposed Rulemaking that led to Order No. 436. It is obvious that the parties to that proceeding did not present their cases in the context of the rate requirements under Order No. 436.

Additionally, there are some parties in the proceeding before us that were not parties to Docket No. RP83-137-011. Although Transco states that those parties should have intervened in Docket No. RP83-137, that is the advantage of hindsight, and we believe it would be unfair to determine transportation rates under the requirements of Order No. 436 in that proceeding. By doing so we would subject parties who had no indication that Order No. 436 issues would be considered in that docket, to the results of that proceeding and foreclose their opportunity to present arguments on those issues in light of the Commission's final rule. We shall therefore reject the settlement provision which provides that the proper design for Transco's interruptible transportation rates will be determined in Docket No. RP83-137-011.

Of course, by doing so, we do not wish to subject customers to rate uncertainty. There are several alternative courses of action we could follow. We could simply determine that the interim rates for firm and interruptible transportation which Transco has filed in this proceeding are just and reasonable. We could reopen the record in Docket No. RP83-137-000 to allow additional evidence and additional parties' participation, as Cheney suggests. Or, we could consolidate the rate issues with Transco's most recent section 4 filing in Docket No. RP87-7-000. 147/

145/ Initial Comments of Indicated Producers at 19; Initial Comments of Pina at 6; Initial Comments of Cheney at 7.

146/ 33 FERC ¶ 63,035 (1985).

147/ On October 6, 1986, Transco filed a section 4 rate increase in Docket No. RP87-7-000, which was accepted and suspended by the Commission's order of November 5, 1986 (37 FERC ¶ 61,089).

With respect to the first alternative, we find sufficient evidence in the record to support the interruptible transportation rates which Transco has filed in this proceeding as just and reasonable and consistent with the requirements of Order No. 436. Pipelines need not file a new rate case to establish rates under Order No. 436. They must only establish rates conforming to section 284.7 of the Commission's regulations. 148/

Southern and Felmont argue that the settlement lacks cost data and other information necessary to support the rates. 149/ Felmont suggests that we require Transco to file workpapers in this proceeding, as we required of Texas Eastern in its Order No. 436 settlement proceeding. 150/ While it is true that workpapers were not filed as part of the settlement, that does not mean that the rates are unsupported. The settlement rates are identical to the interim rates filed in Docket Nos. RP86-111-000 and RP87-9-000. 151/ For both filings, Transco included an Appendix A consisting of workpapers supporting the rates. Since the workpapers filed in these prior dockets contain the same information, it is not necessary to require Transco to file the same workpapers again.

Based on the information contained in the workpapers filed by Transco in Docket No. RP83-137-000 supporting the settlement in that proceeding and information contained in the workpapers filed as Appendix A in Docket Nos. RP86-111-000 and RP87-9-000, we find that the settlement rates are in compliance with section 284.7 of the Commission's regulations.

148/ See El Paso, Order Denying Rehearing, 37 FERC ¶ 61,008, mimeo at 5.

149/ Initial Comments of Southern at 14-16; Initial Comments of Felmont at 4-5.

150/ Texas Eastern, slip op. at 82.

151/ On May 30, 1986, Transco filed, in Docket No. RP86-111-000, rates to continue providing grandfathered transportation service after July 1, 1986. Those rates were accepted, subject to refund, by Commission order issued June 30, 1986. (35 FERC ¶ 61,413). On October 10, 1986, Transco filed tariff sheets to establish firm transportation rates in Docket No. RP87-9-000. Those rates were accepted, subject to refund, by Commission order issued November 7, 1986. (37 FERC ¶ 61,108).

The Indicated Producers contend that the inclusion of advance payments, prepayments, system storage costs and Account No. 858 costs should not be subject to the Commission's determination in Docket No. RP83-137-011, but should be excluded from the rates. Since the settlement rates which we are approving exclude those costs, there is no basis for the objection. 152/

Several parties object to the use of a 100 percent load factor basis for interruptible transportation rates under the settlement. 153/ In several recent orders approving settlements implementing the Commission's open access transportation program, we have approved interruptible rates equivalent to the firm transportation rates computed at 100 percent load factor. 154/ The parties here do not raise any new objections that would cause us to reach a different determination in this proceeding.

PMTG objects to Transco's use of historical zone differentials in determining the transportation rates. PMTG argues that the rates must be mileage based. The settlement provides that the historical zones will be used until the Commission resolves the issue, on a prospective basis, in Docket No. RP82-55-000. This provision is consistent with the settlement in Docket No. RP82-55, which provided for prospective determination of the zone issue that was reserved for hearing in that proceeding. 155/ On December 30, 1986, the Commission issued an order in Docket No. RP82-55, which establishes an Mcf-mile allocation for Transco's system. 156/ Consistent with the Commission's determination in that proceeding, the zone differentials will be changed prospectively and need not be further addressed herein.

152/ Docket Nos. RP86-111-000 and RP87-9-000, Appendix A, page 4 of 6.

153/ See, e.g., Initial Comments of Indicated Producers at 19; Initial Comments of Brooklyn Union at 12.

154/ Texas Eastern Transmission Corp., 37 FERC ¶ 61,260 (1986); Northern Natural Gas Co., 37 FERC ¶ 61,272 (1986).

155/ Transcontinental Gas Pipe Line Corp., 37 FERC ¶ 61,328 (1986), slip op. at 2.

156/ Id., slip op. at 18.

Elizabethtown and Brooklyn Union claim that Transco's settlement rates unfairly charge customers twice for fuel use -- once in the zone differentials and once through the fuel retention percentage, thereby creating a "double whammy." That is incorrect. The cost of fuel is not included in the zone differentials at all. Thus, contrary to the commenters' arguments, fuel costs are not collected twice.

We realize that the actual fuel retention levels are subject to the Commission's final determination in Docket No. RP83-137-011. While we shall not resolve that issue for future periods, we shall allow Transco to retain its actual fuel consumption levels for transportation during the time that the settlement rates are in effect. We shall therefore require Transco to credit its customers for all volumes retained in excess of actual fuel use in providing transportation service during the time that the settlement rates are in effect.

Finally, we note that in Docket No. RP86-111-000, the Commission stated that the settlement "is designed to be revenue neutral, with increased transportation rates to be offset by decreased sales rates." 157/ To avoid net increased revenues to Transco, we required that Transco credit to its Account No. 191 the difference between the revenues received under Rate Schedule IT and the revenue which Transco would receive had it continued to charge its existing transportation rates. Under the settlement, Transco would recover net increased revenues unless its sales rates are reduced. However, in view of the short time period in which the settlement rates will remain in effect before the revised rates become effective in Docket No. RP87-7-000, it would be administratively burdensome to require Transco to file reduced sales rates at this juncture. We believe that the same purpose may be obtained by permitting Transco to continue to credit to its Account No. 191 the difference between the settlement IT rates and the rates charged prior to Transco's filing. Accordingly, as a condition to the settlement we shall require such crediting.

With respect to the second alternative of reopening the record in RP83-137-011, that course of action is not necessary. Several commenters, including Felmont, Southern, Indicated Producers, and PMTG oppose that portion of the settlement which bases the settlement rates for firm and interruptible transportation on

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157/ 35 FERC ¶ 61,413 at 61,942.

the cost and volume levels approved by the Commission in Docket No. RP83-137-000. 158/ These commenters argue that the record in that proceeding is stale, the cost levels are too high, the representative throughput levels cannot be supported as projected levels, and the Seaboard rate design methodology approved in that proceeding is inappropriate.

Indicated Producers have requested that a hearing be established to determine the proper cost of service and volume levels. The problem is that none of the issues could or would be addressed even if we were to reopen the record in RP83-137-011 because those issues were resolved in the underlying settlement. 159/ Thus, in order to consider those issues, we would have to institute an investigation under section 5 of the NGA in order to determine all of the issues raised by the commenters in the context of Docket No. RP83-137. That would be extremely time consuming and, we believe, unnecessary.

We do not disagree with the commenters who argue that the record in Docket No. RP83-137-000 may be stale. However, we do not find that the allegations raised by Indicted Producers rise to the level that would give cause to institute a section 5 proceeding. Furthermore, we believe this type of investigation is unnecessary because Transco's transportation rates are subject to a new determination of cost, volumes and rate design in Transco's current rate proceeding in Docket No. RP87-7-000. The transportation rates in the settlement are based on the record in Docket No. RP83-137-000 only for the interim period from July 1, 1986, to April 1, 1987, a period of nine months, after which a new rate determination will apply. For these reasons, we find that the commenters have failed to raise sufficient justification for us to reopen the record in Docket No. RP83-137-000 to investigate the transportation charges approved in that docket.

We have determined that Transco's settlement rates are, as modified, consistent with section 284.7 of the Commission's regulations, as discussed above. To the extent that the parties wish to raise any issues regarding Transco's transportation charges effective April 1, 1987, they may do so in Docket No. RP87-7-000. In that proceeding, new cost of service and throughput levels may be determined in accordance with Order No. 436. Those commenters who were not parties to Docket No. RP83-137-000 will have the opportunity to fully participate in Docket No. RP87-7-000, and all

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158/ See Initial Comments of Felmont at 3-4; Indicated Producers at 17-19; PMTG at 3-4; Southern at 14.

159/ 28 FERC ¶ 61,146 (1984).

parties will be afforded their full procedural rights. In accordance with this determination, any party to this proceeding who has not been granted party status in Docket No. RP87-7-000 will have an opportunity to intervene in that docket. Any party desiring to do so may file an intervention in Docket No. RP87-7-000 within ten days of the issuance of this order approving Transco's settlement, subject to modification.

Firm Transportation Rates: The settlement also provides for firm transportation rates. Article III of the settlement provides that those rates are based on the fixed costs in the sales rates, excluding the costs associated with Account No. 858 (transportation and compression by others), advance payments, prepayments and storage. The firm rates include a reservation fee and a commodity charge. Although Transco does not provide an explanation in the settlement for the derivation of those charges, support for such charges was filed in Docket No. RP87-9-000.

Unlike the interruptible transportation rates, the firm rates are determined in the settlement and not left for resolution in another pending proceeding. There are many similar elements, however. The firm rates, like the interruptible rates, are based on the costs and volumes approved by the Commission in Docket No. RP83-137-000. The fuel retention levels are also consistent with the levels accepted by the Commission and set for further proceedings in Docket No. RP83-137-011. Consequently, many of the issues raised by the commenters with respect to the interruptible transportation charges apply as well to the firm transportation charges.

For example, several commenters argue that it is improper to base the firm transportation rates on the costs and volumes approved in the underlying settlement in Docket No. RP83-137-000. Hence, the reasons for which we rejected such claims by the commenters as to the interruptible transportation rates must also apply to the firm transportation rates. Moreover, consistent with our determination regarding the IT rates, we shall approve Transco's fuel retention during the period that the interim and settlement rates are in effect only to the extent of actual use in performing transportation service, and require that Transco credit to its transportation customers amounts retained in excess of such levels. Accordingly, we shall approve the settlement firm transportation rates, subject to the conditions set forth herein, and allow the parties to raise any issues regarding the rates to be effective April 1, 1987, in Docket No. RP87-7-000.

Minimum Commodity Bill for Firm Transportation: Brooklyn Union argues that a minimum bill identical to the minimum commodity bills found in Transco's Rate Schedules CD and MDQ, should be included in Rate Schedule FT. We disagree. Section 284.8(d) provides that "the pipeline may not include in a rate for any transportation under Subpart B, C, G, or H any minimum bill or minimum take provision, or any other provision that has the effect of guaranteeing revenue." 160/ Brooklyn Union is aware of section 284.8(d) but submits that modification of that provision is justified here. The reason this modification is needed, Brooklyn Union submits, is to prevent cost shifting that may occur as a result of firm sales customers converting to firm transportation and thus avoiding the minimum bill. As we held in Texas Eastern, the regulation is not a policy statement but a "legislative regulation that is binding unless and until the regulation itself is changed." 161/

Backhaul Rates: Transco has included in the settlement backhaul rates for IT service equal to one half of the forward haul rates. There are no backhaul rates under Rate Schedule FT.

The Indicated Producers note that they are unable to find such rates in the settlement. However, the rates are listed as "upstream rates" in Appendix A, page 6, of the workpapers filed in Docket No. RP86-111-000 and Docket No. RP87-9-000. In any event, Indicated Producers claim that the settlement should include separate backhaul rates containing only the administrative costs of the service. In a similar vein, Brooklyn Union argues that the settlement should also include separate backhaul rates for firm service. NCUC alleges that the backhaul rates are unsupported and should be subject to resolution in Docket No. RP83-137-011.

We have previously determined that companies need not establish separate rates for backhaul service. 162/ For the same reasons that we declined to resolve the IT rates in Docket No. RP83-137-011, we do not consider it reasonable to subject the backhaul rates to a determination in that proceeding.

Accordingly, we shall approve the backhaul rates. However, we believe that customers should be permitted to raise these issues as to Transco's future rates. We shall therefore allow the parties to raise these issues in Transco's current rate proceeding in Docket No. RP87-7-000.

160/ 18 C.F.R. § 284.8(d) (1986).

161/ Texas Eastern, slip op. at 110.

162/ Texas Eastern, slip op. at 110.

VII.

SALES RATE ISSUES

A.
Flexible PGA

Transco has proposed a new section 22.8 to the General Terms and Conditions of its Tariff to permit Transco, on a monthly basis, to adjust its jurisdictional rates to reflect a revised average cost of gas between its regularly scheduled purchased gas adjustment (PGA) filing dates. 163/ Currently, section 154.38(d)(4)(iv)(a) of the Commission's regulations 164/ and section 22 of Transco's tariff permit Transco to adjust its rates on a semi-annual basis.

The Commission has approved several interim gas cost adjustment filings, or flexible PGAs, in recent orders. 165/ Transco's proposal is similar to those proposals submitted by other pipeline companies and approved, subject to certain conditions, by the Commission in its prior orders. Transco's proposal is similar, in many respects to a flexible PGA proposal we approved for Texas Eastern Transmission Corporation in Texas Eastern's Order No. 436 settlement. 166/

Transco's proposed tariff language will permit it to file such interim gas cost adjustments no more frequently than monthly. At least ten days before the first day of the applicable month in which the revised cost of gas shall become effective, Transco shall file with the Commission a statement showing the computation of the adjustments made in its current cost of gas. Transco shall file the interim adjustments with at least ten days notice to be effective on the first day of any month during the PGA period.

Transco's proposal would permit it to adjust its rates upward or downward but would limit any upward adjustment to a revised cost of gas not greater than 5 percent higher than the current cost of gas included in Transco's last fully supported PGA filing. In many of the flexible PGA proposals approved by the Commission, we permitted only gas cost adjustments that would reflect a lower

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163/ The semi-annual PGA adjustment dates for Transco are November 1 and May 1.

164/ 18 C.F.R. § 154.38(d)(4)(iv)(a) (1986).

165/ Northwest Central Pipeline Corp., 37 FERC ¶ 61,055 (1986); Kentucky West Virginia Gas Co., 37 FERC ¶ 61,075 (1986).

166/ 37 FERC ¶ 61,260 (1986).

cost of gas. However, in Texas Eastern, supra, we approved a similar interim adjustment plan that allowed Texas Eastern to make interim filings reflecting an increased cost of gas not in excess of 5 percent above the current cost of gas included in its last fully supported PGA filing. We did so because Texas Eastern's proposal was more restrictive than other flexible PGAs we had approved in that Texas Eastern was only permitted to file monthly adjustments. Accordingly, we shall permit Transco to file interim adjustments which reflect a revised cost of gas that is no more than 5 percent higher than the cost of gas reflected in Transco's last fully supported PGA filing.

In addition to the interim adjustments, Transco also proposes to file, upon at least ten days notice to be effective on the first day of any month during the PGA period, a revised purchased gas adjustment. That filing will include the detailed schedules supporting the requested change in gas costs. The purpose of the filing will be to increase Transco's gas cost above the 5 percent limit provided under the interim adjustments described above. Transco states that these revised purchased gas adjustment filings would be treated by the Commission for purposes of determining acceptance or suspension as if such filings were made pursuant to Transco's semi-annual PGA provisions. This appears to be nothing more than the right Transco now has to file an out-of-cycle PGA reflecting a reduction or an increase in gas costs. There is one difference, however. Under the settlement provision, Transco would give only ten days notice rather than the 30 days required by the regulations. We cannot approve the provision as it now reads for the reason that 10 days notice for this type of filing which could increase Transco's gas cost above the 5 percent limit is not sufficient. Transco may have the right to file these monthly adjustments but it must give the 30 days required notice.

Transco has proposed a 3 percent margin for undercollections which is identical to other flexible PGA proposals approved by the Commission. Transco states that it will not automatically be permitted to collect any undercollections which exceed the 3 percent margin without prior Commission approval. Staff has raised one objection with respect to this provision. Staff notes that Transco's proposed language fails to reflect that the 3 percent margin for undercollections under the interim cost of gas adjustments does not apply to the extent that interim adjustments fail to reflect actual known changes in supplier gas costs or changes in supplier mix. The language provides that the 3 percent margin would not apply to the extent the interim adjustments fail to reflect changes during the 12 month period. Thus, staff contends, Transco would be permitted to choose when during the 12 month period it wished to reflect a significant change in its cost of purchased gas rather than reflecting these changes as they occur. Staff fears that

Transco could then offset overrecoveries in part of the 12 month period against underrecoveries in another part. We agree. The mechanism provided is intended to track actual gas costs and should not permit Transco to intentionally offset over and undercollections of gas costs. This provision is inconsistent with the Commission's decisions in Northwest Central, and Kentucky West, supra, and other Commission orders approving flexible PGA proposals. 167/ Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to clarify that the 3 percent margin does not apply to the extent that interim adjustments fail to reflect actual known changes in supplier gas costs or changes in supplier mix.

The staff raises two other points about the settlement that relate to Transco's proposed flexible PGA. The first concerns the imposition of filing fees for any interim adjustments filed by Transco. The settlement provides that the Commission shall waive its filing fees for any interim adjustments filed during the six month PGA period. Staff correctly notes that the Commission denied requests for waiver of the filing fees associated with the filing of rate changes under flexible PGAs in earlier orders issued in Florida Gas Transmission Company and Transwestern Pipeline Company. 168/ Consistent with the Commission's orders in those proceedings, we shall deny Transco's request for waiver of filing fees with respect to interim gas cost adjustment filings. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to eliminate this language.

Staff's other point relates to section 22.7 which provides for a deferred adjustment to account for the over or underrecovery of purchased gas costs. That section provides that the unrecovered cost of purchased gas is to be recovered over a 12 month period. Transco proposes to base its annual surcharge to be effective April 1 on the actual balance of the deferred account as of two months prior to the effective date as adjusted for estimated recoveries in the two months (February and March) prior to the effective date. Additionally, the annual April 1 surcharge will include the under or over amortized balance under the prior year's surcharge. We agree that the use of estimates for the two month period is inappropriate and inconsistent with the Commission's regulations which provide, in Part 201, for the maintenance of separate subaccounts within Account No. 191 so that the deferred gas costs for a period are matched with the revenues recovered

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167/ See also, Arkla Energy Resources, 36 FERC ¶ 61,386 (1986).

168/ Florida Gas Transmission Co., 34 FERC ¶ 61,406 (1986); Transwestern Pipeline Co., 34 FERC ¶ 61,409 (1986).

under a surcharge calculated to amortize that balance. If the deferred gas costs are under or over amortized because of a difference in actual versus estimated sales volumes, the remaining balance is transferred to the subaccount in which current deferred costs are being accumulated. Inclusion of estimates in the deferred account is contrary to the stated purpose of the deferred account -- to reflect and account for actual over and underrecoveries experienced in a previous period. Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to eliminate its ability to estimate recoveries and surcharge recoveries for the two month period.

Two other commenters have addressed this provision. Fina states that Transco should be able to adjust its PGA on a monthly basis in order to reflect changes in supplier gas prices as soon as those changes become reasonably foreseeable. PGW asks that we condition our approval of this portion of the settlement on the same conditions we have imposed in prior orders approving flexible PGA proposals. We think we have done so. With respect to Fina's suggestion, Transco's proposal will permit it to make monthly adjustments to reflect changes in gas prices but only to reflect known and actual changes, as we have required.

Thus, with the exceptions noted above, we find Transco's interim gas cost adjustment proposal to be consistent with similar proposals approved by the Commission in prior orders. All of the conditions imposed in the Commission's orders in Northwest Central and Kentucky West, supra, shall apply to Transco's interim gas cost adjustments, and our acceptance of that portion of Transco's settlement shall be so conditioned.

B.
Minimum Commodity Bill

Several commenters, including Citizens, Columbia, and Southern, argue that the Commission should eliminate Transco's minimum commodity bill in this proceeding. That issue is not before us. However, the Commission, in Docket No. RP82-55, issued an opinion on December 30, 1986, which found Transco's minimum commodity bill to be unjust and unreasonable. 169/

169/ Transcontinental Gas Pipe Line Corp., Opinion No. 260, 37 FERC ¶ 61,328 (1986). The opinion is subject to rehearing.

Another question related to the minimum bill is raised, however. That is how credits to the minimum bill, as required by section 284.10(d)(5) of the Commission's regulations are to be applied. These credits apply to Rate Schedule MDQ sales customers. Section 284.10(d)(5) provides that any customer who converts any portion of its firm sales entitlements from a pipeline must receive a credit to any minimum bill obligation that the customer may have for each unit of firm transportation service purchased. Article II, Section 8, of the settlement provides that, subject to the 30 percent best efforts purchase commitment, described above, long-haul transportation quantities transported by Transco for (1) customers, (2) customers on behalf of, or as agent for, end-users served by the customers, and (3) end-users served directly by the customers, shall be considered as having been purchased from Transco for purposes of the customers' minimum commodity bill obligations under the sales rate schedules.

Citizens argues that Article II, Section 8, is inconsistent with section 284.10(d)(5) and that Transco should not be permitted to deny those credits based on a customer's failure to achieve its 30 percent best efforts obligation. We agree. We have discussed the best efforts commitments, supra, and held that they represent tying arrangements expressly prohibited by Order No. 436. (See p. 18-21, supra). Transco must provide minimum bill credits as set forth in section 284.10(d)(5) of the regulations. If Transco desires to provide credits which exceed the scope of what is provided in the regulations, it may do so. However, those credits may not be tied to any best efforts purchase obligations on the part of its customers.

Brooklyn Union argues that minimum bill credits should be provided for short-haul transportation as well as long-haul. We agree with Brooklyn Union that volumes applicable to short haul transportation should receive the same credit as those applicable to long haul. Accordingly, we shall require that Transco modify this provision of the settlement to so provide.

South Carolina Pipeline (South Carolina) objects to Article III, Section 3, which provides that transportation volumes will receive credit for minimum commodity bill obligations, except for customers purchasing under the CD Rate Schedule. Thus, South Carolina argues that while MDQ Rate Schedule customers would receive minimum bill credit for transportation services, the credit would be denied CD Rate Schedule customers. South Carolina argues that there is no rationale for treating the CD and MDQ customers differently. We agree. To the extent any CD customers convert a portion of their sales entitlements to firm transportation, they are eligible under the regulations, for credits to their minimum bill obligations. Additionally, to the extent any CD customer

reduces its firm sales entitlement, pursuant to section 284.10, it will receive a proportionate reduction in its minimum bill obligation. Transco has failed to provide any reason for the distinction made in Article III, section 3. We shall condition our approval of the settlement on Transco filing revised tariff language to provide that minimum bill credits shall be given for all firm service. Virginia Natural Gas (VNG) contends that minimum commodity bill credits should be given for volumes transported by Transco for customers on behalf of, or as agent for, local distribution company customers served by Transco customers and for customers on behalf of, or as agent for, end-users served by local distribution companies served by Transco customers. Transco has agreed to this change.

Accordingly, we shall condition our approval of the settlement on Transco filing revised tariff sheets to clarify that it will provide minimum commodity bill credits as provided in section 284.10(d) and that to the extent it extends credits beyond that provided for in the regulations, it may not tie such credits to customers' best efforts purchase obligations.

VIII.

MISCELLANEOUS ISSUES

A.

Applicability of Order No. 436 to Storage Facilities

Article IV, section 2, provides that Transco's storage services or storage facilities which are "system storage," are not subject to the open access provisions of Order No. 436. Indicated Producers, Fina, PMTG, Pennzoil, U.S. Steel and several other commenters oppose this provision. They argue that it is inconsistent with Order No. 436. PGC, on the other hand, asks the Commission to clarify that even if Transco is unable to make its existing storage capacity available on a nondiscriminatory basis at the present time, Transco must make it available if system storage capacity becomes available in the future.

Transco states that it is necessary to exclude its system storage from open access because all of the storage facilities and services on Transco's system are either already dedicated to specific customers or are dedicated for the system use and operational requirements of Transco in performing its merchant function. Thus, Transco avers, opening its storage to new requests would jeopardize the services and operations to which this storage is dedicated.

Sections 284.8(b) and 284.9(b) require pipelines to provide access to their transportation facilities without undue discrimination. In Order No. 436 the Commission determined that, because pipelines use their system storage facilities for the same purpose they use their transportation facilities, it is reasonable to require pipelines to provide shippers access to system storage on the same basis they provide access to their transportation facilities. 170/

Thus, to the extent that Transco uses its storage facilities for system storage, those facilities are subject to the non-discriminatory access provision. The fact that Transco's storage capacity is presently full does not exempt it from open access. It would be no different if Transco's firm transportation capacity were currently booked. It does not mean that transportation capacity is excluded from the open access requirement. Accordingly, we find that the settlement provision excluding system storage from the open access provisions of Order No. 436 is inconsistent with the terms of that order. This is true only for system storage. It does not apply to contract storage.

B.
Issues Relating to Transco's Affiliates

Several commenters, including Citizens, Con Edison, and Fina have raised issues concerning Transco's relationship with its marketing affiliate, TEMCO, and other Transco affiliates. Fina contends that it is virtually impossible for a non-affiliated shipper to obtain new interruptible transportation on Transco's system. This is so, Fina argues, because TEMCO, which purchases most of its gas from another Transco affiliate, TXP Operating Company (TXPO), already has all the available capacity locked up for transactions in which TEMCO supplies gas to Transco's existing customers. Fina raises this issue in the context of Transco's allocation plan for allocating interruptible capacity. There, as we discussed above, after providing for firm sales and transportation services, Transco will allocate remaining pipeline capacity among interruptible customers whose contracts were in effect as of October 9, 1985, and thereafter, on a first-come, first-served basis among interruptible customers purchasing services under the IT Rate Schedule. We have discussed this issue above (see p. 57-64) where we found that the distinction made between pre-October 9, 1985 arrangements and post-October 9, 1985 arrangements was proper

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170/ Order No. 436 at 31,507; Texas Eastern, slip op. at 122-23.

and fully consistent with Order No. 436. Therefore, we do not believe that Pina has raised any valid objection with respect to Transco's treatment of non-affiliated shippers.

Under Article I, section 5, of the settlement, gas released by Transco and subsequently repurchased by Transco from an affiliate will be repurchased at cost, except in the case where the gas was produced by the affiliate. Con Edison does not object to this provision but argues that it does not go far enough. Con Ed argues that the provision should apply to purchases of non-released gas by Transco from an affiliate as well. Con Ed requests that the Commission include language in its order which "makes clear that Transco may not use affiliates to circumvent its statutory duty to provide reliable gas service at the lowest reasonable cost." 171/

We do not believe that this language is necessary. Transco states that the specific limitation in Article I, section 5 was added for the express purpose of addressing a concern stated by certain of Transco's customers regarding future purchases from gas supply sources under contract to Transco as of the effective date of the settlement which are "covered reserves" eligible for non-recoupable cash settlement payments under Article V. In order to dispel any concerns about possible self-dealing, the provision in Article I, section 5, was agreed to. We do not believe that this provision needs to be expanded or modified.

Further, we note that in Article IV, section 2, there is a specific provision concerning Transco's affiliates. That provision reads as follows: "It is understood and agreed that neither TEMCO nor any other affiliate of Transco shall be given any preference with respect to transportation nomination procedures, allocation of capacity, curtailment of service, transportation rates, or any other factor bearing upon the availability of transportation service on the Transco system." We believe that this provision provides sufficient protection to Transco's customers. If specific examples of wrongdoing occur in the future, Transco's customers have the right to file a complaint with the Commission.

171/ On November 14, 1986, in Docket No. RM87-5-000, the Commission issued a Notice of Inquiry into alleged anticompetitive practices related to marketing affiliates of interstate pipelines. This may provide another forum in which customers may raise issues regarding Transco's treatment of affiliates.

C.

Treatment of Purchases of Great Plains Gas

Article II, section 4 of the settlement offer proposes that an evidentiary hearing be held in Docket No. TA86-1-29-000 to address the issue of whether Transco should continue to recover, through its PGA, the costs of its purchases of synthetic natural gas (SNG) from Great Plains Gasification Associates (Great Plains). The section provides that such resolution would be effective on a prospective basis from the date of a final Commission order. The provision is supported by a number of parties, and is opposed by the Department of Energy (DOE).

Transco's purchase of a portion of the SNG produced at the Great Plains facility was authorized in Opinion No. 119 (Great Plains Gasification Associates, 15 FERC ¶ 61,106 (April 30, 1981)). An extensive loan guarantee, amounting to more than $1.5 billion, was extended by DOE on the basis of that authorization. Since that time, the original sponsors have defaulted and operation of the Great Plains project has been taken over by DOE.

The purchasing pipelines requested and were granted advance approval of the gas purchase agreements which formed the financial predicate for the project. The Commission recognized that its determination would provide the basis for long-term reliance by the sponsors and DOE to invest in the project:

> As we have previously stated, both the sponsors and the DOE, as guarantor of the debt, must be able to rely upon the Commission's finding of prudence as a basic condition of their decision to invest the sums of money required for this project... In our opinion, this determination can only be made once and based on the facts before us we should not, and will not, further condition this order to allow for further review of this determination. (15 FERC at 61,242).

The order also rejected a proposal by the State of Michigan that the pricing mechanism be subject to review in the context of the purchasing pipelines' PGA filings:

> Once this synthetic gas begins to flow and is reflected in the participating pipelines' rates, any party would have the opportunity to challenge the calculation of the rate under the pricing formula in the pipeline PGA filings. However, such challenge would, of necessity, be limited to the accuracy of the determinations made under the various price ceilings. The reasonableness and prudence of the pipelines' action in entering into the Gas Purchase Agreements is a determination which must be made now and cannot be continuously reopened and reviewed. (15 FERC at 61,241-42).

The authorization granted by Opinion No. 119 for Transco's continued recovery of the costs of its Great Plains purchases was cited when the Public Advocate of New Jersey, earlier this year, requested that we deny Transco recovery of any costs related to Great Plains gas. The order noted that Tranco's purchases of the gas had been fully authorized and did not include Great Plains gas costs in the hearing established to explore Transco's continued purchases of high cost gas. 172/

Opinion No. 119 also was relied on in an October 1985 order suspending a PGA adjustment filed by ANR Pipeline Company, another of the pipelines purchasing SNG from Great Plains. 173/ Michigan Consolidated Gas Company had argued that purchase of Great Plains gas would be imprudent should a final court order determine that no purchase obligation exists, and requested that Great Plains costs incurred after August 1, 1985 be collected subject to refund, pending the outcome of litigation involving the pipeline's gas purchase agreement with Great Plains. The order held:

> On April 30, 1981, the Commission issued Opinion No. 119 which authorized pipelines to recover in their jurisdictional rates, on a rolled-in basis through the PGA, payments made to Great Plains under gas purchase agreements. In that opinion we concluded that it would be reasonable and prudent for Michgan Wisconsin Pipe Line Company (now ANR) and other interstate pipeline companies to enter into the gas purchase

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172/ Transcontinental Gas Pipe Line Corp., 35 FERC ¶ 61,139 (1986).

173/ ANR Pipeline Co., 33 FERC ¶ 61,073 (1985).

> agreements with Great Plains, and reflect the charges in their rates. In light of the rate authorizations in that opinion we will not place the prudence of the Great Plains purchases in issue at this time. We will, however, require ANR to file revised tariff sheets to reflect the elimination of Great Plains purchases in the event Great Plains ceases production. (33 FERC at 61,164).

We are aware that Tranco's continued purchases of SNG from Great Plains constitutes a high-cost source of gas under current market conditions and can appreciate that its customers, and presumably Transco itself, would like for it to be relieved of this gas purchase obligation. Nevertheless, Opinion No. 119 recognizes that major financial commitments would be made in reliance on the gas purchase authorizations granted therein, and clearly and unequivocally conveys the Commission's position that these authorizations would not thereafter be changed or abrogated so long as the project remains in operation. No party has even alleged the existence of any circumstances in the execution or approval of the gas purchase agreements to warrant their modification or elimination.

Rule 217 of the Rules of Practice and Procedure provides for the summary disposition of all or part of a proceeding if a determination is made that there is no genuine issue of fact material to the decision. The passthrough of the Great Plains costs was approved in Opinion No. 119. That decision is not subject to the reopening or review by the Commission under the existing circumstances. Transco and the parties supporting Article II, section 4 of the settlement offer have shown no reason why the proposed "evidentiary hearing" should not be disposed of under Rule 217. Accordingly, this section of the settlement offer will not be approved. 174/ As in the case of the ANR Pipeline Company order referred to above, Transco will be required to file revised tariff sheets to reflect the elimination of the Great Plains purchases in the event Great Plains ceases production.

174/ The references to Great Plains gas pricing in Article II, paragraph 6, and Article VI, section 1 of the settlement offer also are deleted.

D.

Sulpetro Costs

Background

Since 1980, Transco has been authorized by DOE's Economic Regulatory Administration to import natural gas produced by Sulpetro, Limited, a Canadian company. 175/ The current import authorization extends to October 31, 1994. The gas purchased by Transco from Sulpetro is produced in Alberta, Canada and transported through Canadian pipeline facilities to a point near Niagara Falls, New York, on the U.S.-Canadian border, where the gas is delivered to Tennessee Gas Pipeline Company (Tennessee) for the account of Transco.

Transco and other importers of Canadian gas have proposed to construct a pipeline from Niagara Falls to serve American markets in the northeast. 176/ Pending Commission action on the proposed pipeline, Tennessee, Consolidated Gas Transmission Corporation (Consolidated), and National Fuel Gas Supply Corporation (National) have provided interim, interruptible transportation under the self-implementing agreements grandfathered by Order No. 436. 177/ Pursuant to section 284.125 of the Commission's Regulations, National's transportation authority expired on July 1, 1986, while authority for Tennessee and Consolidated expired on November 1, 1986, with the expiration of the contracts. 178/

175/ Transcontinental Gas Pipe Line Corp., ERA Docket No. 79-08-NG, 1 ERA ¶ 70,512 (1980); ERA Docket No. 81-30-NG, 1 ERA ¶ 70,540, (1982); ERA Docket No. 84-06-NG, 1 ERA ¶ 70,573 (1984).

176/ See Transcontinental Gas Pipe Line Corp., Docket Nos. CP82-46-000, et al., 24 FERC ¶ 61,003 (1983), modified, Boundary Gas, Inc., et al., Docket No. CP81-107-000, et al., 24 FERC ¶ 61,070 (1983).

177/ See Order No. 60, 18 C.F.R. § 284.221 (1985).

178/ This authority was extended by Commission order in Consolidated Gas Transmission Corp., Docket No. CP86-729-000, 37 FERC ¶ 61,214 (1986).

After receiving Transco's gas at its international border facility, Tennessee redelivers equivalent volumes for Transco's account to either Consolidated or National at five existing delivery points in New York, Pennsylvania, and New Jersey. The bulk of this gas, up to 75,000 dekatherms per day (dth/d), is delivered to Transco through the systems of Tennessee and Consolidated. National, whose transportation service for Transco is incidental to storage services provided by Penn-York Energy Corporation (Penn-York), receives up to 20,000 dth/d from Tennessee and delivers equivalent volumes to Penn-York for storage. 179/

In addition to the self-implementing transportation provided by Tennessee, Consolidated, and National, Transco has filed at least 72 reports for self-implementing transportation provided on behalf of customers who purchase Sulpetro gas from Transco on a "direct assignment" basis. Under this program, Transco purchases the Sulpetro gas as agent for customers it considers eligible for "direct assignment" and resells the gas to those customers. 180/

Transco has pending an application in Docket No. TA85-1-29-000 to include in its rates the demand charges it pays to Sulpetro on an "as-billed" basis. The request was set for hearing. 181/ On September 3, 1985, an initial decision was issued by the administrative law judge recommending that Transco's request be approved. 182/ The initial decision is before the Commission on exceptions.

In a May 14, 1986 PGA filing in Docket No. TA86-5-29-003, Transco implemented, as of May 1, 1986, a temporary 25 percent reduction in the pass-through of the Sulpetro demand charges in accordance with the settlement offer here being considered. 183/

179/ National Fuel Gas Supply Corp. and Penn-York Energy Corp., Docket Nos. CP76-492-031, et al., 29 FERC ¶ 61,034 (1984), modified, 29 FERC ¶ 61,311 (1984).

180/ The Commission's order of December 8, 1986, in Consolidated Gas Transmission Co., et al., Docket No. CP86-729-000, specifically limited the transportation authorization granted in the order to gas for Transco's system supply. The Commission noted that any other use by Transco will require specific authorization. 37 FERC ¶ 61,214 at 61,532.

181/ 29 FERC ¶ 61,148 (1984).

182/ 32 FERC ¶ 63,081 (1985).

183/ 35 FERC ¶ 61,305 (1986).

In its subsequent semi-annual PGA filing on October 1, 1986 in Docket No. TA87-1-29-000, Transco restored its full demand cost associated with the pass-through, on an as-billed basis, of the Sulpetro demand charges. 184/

Settlement Offer

In Article VI, Section 1 of the settlement offer, Transco has proposed that upon the effectiveness of the settlement, new tariff sheets would be made effective eliminating 25 percent of the Sulpetro demand charges from its demand charges. Such billing treatment would continue until the Sulpetro supply is released by Transco, "which shall occur no later than November 1, 1986; the Sulpetro issue pending on exceptions to the ALJ's decision shall be considered settled and withdrawn." Transco agrees to make a rate filing, effective concurrently with its release of the Sulpetro supply, "but in no event later than November 1, 1986, reflecting the elimination of Sulpetro demand charges from Transco's demand charges." The section also states:

> Further, in order to provide the necessary self-implementing transportation authority for intermediate pipelines during the remainder of the import period, Commission approval of this Stipulation and Agreement shall be tantamount to a finding that Sulpetro import quantities shall be deemed to be Transco system supply for the purpose of such authorizations so long as such supplies are offered to all customers on the basis of their respective firm sales contract entitlements with Transco.

Comments on Transco's proposed treatment of the Sulpetro issue were filed by PGW, Pina, and the Commission's staff. PGW recommends that the validity of the flow-through of the Sulpetro demand charges be left for decision in Docket No. TA85-1-29-000. Pina requests that Transco be required to forego any further purchases from Sulpetro or that such imports, if purchased by Transco's customers, not be deemed part of Transco's system supply. Staff likewise objects to the characterization of the Sulpetro volumes as part of the pipeline's system supply.

184/ 37 FERC ¶ 61,076 (1986).

Commission Decision

On December 8, 1986, we resolved the question of as-billed treatment of Canadian gas costs in Natural Gas Pipeline Company of America, Opinion No. 256. 185/ There we permitted as-billed treatment of two-part Canadian gas rates but found Natural's demand charge to be unjust and unreasonable. Accordingly, we ordered Natural to file revised tariff sheets to reflect our determinations regarding the proper cost classifications and allocations found just and reasonable consistent with Commission precedent for domestic pipelines. 186/ We found that such treatment was consistent with the intent of the ERA that Canadian imports be treated no differently from American supplies. 187/ Consistent with our action in Opinion No. 256, we shall condition our approval of the settlement on Transco's filing revised tariff sheets to reflect the cost functionalization and classifications consistent with that order, subject to the Commission's approval.

We noted above (see fn. 180) that Transco purchased Sulpetro volumes as "agent" for customers on a direct assignment basis and then resold the gas to those customers. We noted as well that the Commission's December 8, 1986 Consolidated order specifically conditioned the transportation authorization to gas for Transco's system supply. It is unclear to us whether Transco is continuing to import gas from Sulpetro. According to the terms of the settlement, Transco was to release the Sulpetro supply no later than November 1, 1986. To the extent that Transco continues to receive the gas, it must do so in a manner that is consistent with the certificate authority granted by the Commission's December 8, 1986 Consolidated order.

As we observed, Transco, in its May 1, 1986 PGA filing, removed 25 percent of the Sulpetro demand charges in its demand charges for the six-month PGA period. However, in its November 1, 1986, PGA filing, Transco reinstated the full demand cost associated with the Sulpetro demand charges. We wish to make it clear that Transco may not, at any future time, seek to restore the 25 percent of the Sulpetro demand charges it removed for the May 1- October 31, 1986 PGA period.

185/ Natural Gas Pipeline Company of America, Opinion No. 256, 37 FERC ¶ 61,215 (1986).

186/ 37 FERC ¶ 61,215.

187/ Id.

E.

Interventions

Subsequent to the filing of Transco's settlement, we determined that proper notice had not been given of the fact that the proposed settlement contained provisions under the Commission's Order No. 436. Accordingly, we published a notice in the Federal Register on August 15, 1986, and directed persons seeking to intervene to file their petitions by September 2, 1986. Several late petitions to intervene were received by the September 2 date, as well as two filed late, one on September 3, 1986, and one on September 8, 1986. Two of the late intervenors, Cheney Energy Corporation (Cheney) and Fina Oil and Chemical Company, Fina Oil & Gas, Inc., and Fina Exploration, Inc. (Fina) filed comments, as permitted by the Federal Register notice.

On September 12, 1986, Transco filed reply comments in response to the comments filed by Cheney and Fina. Transco argued that the Commission should not have invited comments to the settlement at that late date. Particularly with respect to Fina, Transco argued that since Fina had earlier intervened in one of the dockets referenced in the settlement (TA86-1-29-002), it was required to file comments on Transco's offer of settlement by May 23, 1986, the date when comments were originally due. Transco then moved to strike Fina's comments.

We disagree. When we published the notice in the Federal Register on August 15, 1986, we did so for the reason that Transco's settlement presented many issues that are of great significance to the Commission's implementation of Order No. 436. We have permitted late interventions in several other Order No. 436 proceedings. 188/ The issues we decide in this case will be of considerable importance not only to Transco's existing customers but to any potential shipper who desires transportation on its system as it becomes an open access transporter under Order No. 436. We find Transco's contentions with respect to Fina's late filed comments to be without merit.

In light of our decision to publish a new notice, we shall grant each late filed petition to intervene, including the two mentioned above which were filed after the September 2, 1986, date. Transco's motion to strike Fina's comments is denied.

188/ See, e.g., El Paso Natural Gas Co., 35 FERC ¶ 61,440; Transwestern Transmission Corp., 36 FERC ¶ 61,098.

On January 14, 1987, a petition to intervene out-of-time was filed by Louisiana Gas Marketing (formerly Faustina Pipe Line Company). Louisiana Gas Marketing states that it is a party to Transco's blanket certificate proceeding in Docket No. CP86-405-000. Louisiana Gas Marketing states that it expected, by virtue of its intervention in Docket No. CP86-405-000, to have the opportunity to participate in any proceedings related to the implementation of Order No. 436 on Transco's system. Louisiana Gas Marketing now believes that its intervention in Docket No. CP86-405-000 may be insufficient to protect fully its interest in transportation on Transco's system. Accordingly, Louisiana Gas Marketing desires to intervene in the Order No. 436 settlement proceeding to protect its interests.

Inasmuch as these proceedings, the blanket certificate proceeding in Docket No. CP86-405-000 and the Order No. 436 settlement proceeding in the above-captioned dockets, are closely related, and inasmuch as the Commission's action in Docket No. CP86-405-000 is conditioned upon Commission action taken in Docket No. TA85-1-29-000, et al., we believe that Louisiana Gas Marketing has demonstrated a sufficient interest in the instant docket. Accordingly, we shall grant their late filed petition to intervene.

F.

Term of Settlement

Article IX states that the settlement, with the exception of Article I, sections 3 and 5 (covering release of gas supplies), Article II, sections 3 and 9 (covering billing of transition costs and reduction in minimum bill level for Rate Schedule ACQ customers), Article III (all provisions relating to the period beginning April 1, 1987) , Article IV (settlement transportation rates), and Article V (Buyout provisions) shall terminate on the date that a general rate change filing by Transco under section 4 of the NGA is made effective or on the effective date of any change in rates resulting from any rate proceeding under the NGA instituted against Transco, whichever first occurs.

Since the settlement was filed on May 13, 1986, Transco has filed a section 4 general rate change. Transco made that filing in Docket No. RP87-7-000 on October 6, 1986, with a proposed effective date of November 6, 1986. On November 5, 1986, the Commission issued an order 189/ which accepted and suspended the

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189/ 37 FERC ¶ 61,089 (1986).

rates for a five month period, to become effective on April 1, 1987, subject to refund and certain other conditions. Thus, by the terms of Transco's settlement, all settlement provisions with the exception of those listed above, would expire on April 1, 1987. For purposes of this order, we will leave undisturbed the provisions of Article IX of the settlement. We will instead permit the pipeline and its customers to negotiate the continuation of the settlement provisions in its ongoing section 4 proceeding in Docket No. RP87-7-000.

The Commission orders:

(A) Subject to the modifications, conditions, and clarifications in this order and in the companion orders issued in Docket Nos. CP86-405-000, CI86-297-000, and CI86-293-000, the offer of settlement is approved.

(B) Within 45 days of the issuance of this order, Transco shall file revised tariff sheets in lieu of those at issue herein, in accordance with the terms of this order and the Commission's Rules and Regulations, and subject to the Commission's approval. However, if applications for rehearing are pending at the close of the 45 days period, the above mentioned filing shall be made 30 days from the date the applications are disposed of by the Commission.

(C) Transco's proposed take-or-pay surcharge mechanism is deferred for consideration in Docket No. RP87-7-000.

(D) Transco's interim settlement transportation rates, effective from July 1, 1986, through March 31, 1987, are accepted. The transportation rates to be effective on April 1, 1987, will be considered in Docket No. RP87-7-000. Any party who is not a party in Docket No. RP87-7-000 may file an intervention in Docket No. RP87-7-000 within ten days of the issuance of this order.

(E) Within 30 days of the issuance of this order, or, if an application for rehearing is filed, within 10 days from the issuance of an order thereon, Transco shall inform the Commission in writing whether it accepts the settlement as modified.

(F) The petitions to intervene of Arco Oil and Gas Company, BHP Petroleum (Americas), Inc., Cheney Energy Corporation, Chevron U.S.A., Inc., Fina Oil & Chemical Company, Fina Oil & Gas, Inc., and Fina Exploration, Inc., Kerr-McGee Corporation, Louisiana

Gas Marketing, Natural Gas Clearinghouse, Inc., New Jersey Natural Gas Corporation, Shell Offshore, Inc., and Shell Western E&P, Inc., Tennessee Gas Pipeline Company, and TransAmerican Natural Gas Corporation are granted.

(G) Transco's motion to strike the late filed comments of Fina Oil and Chemical Company, Fina Oil & Gas, Inc., and Fina Exploration, Inc., is denied.

By the Commission. Commissioner Stalon dissented with a separate statement to be issued later. Commissioner Trabandt voted present.

(S E A L)

Lois A. Cashell
for Kenneth F. Plumb,
Secretary.

The CHAIRMAN. Next we would like to welcome the Honorable George S. Dunlop, who is Assistant Secretary for Natural Resources and Environment at the Department of Agriculture.

Senator FORD. He knows more about tobacco.

The CHAIRMAN. Glad to have you, Mr. Dunlop. [Laughter.]

Senator Ford would like you to begin with tobacco.

Senator FORD. George, did you get that message? Start with your statement on tobacco, would you?

STATEMENT OF HON. GEORGE S. DUNLOP, ASSISTANT SECRETARY FOR NATURAL RESOURCES AND ENVIRONMENT, DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY HON. F. DALE ROBERTSON, CHIEF, FOREST SERVICE, DEPARTMENT OF AGRICULTURE, AND GEORGE LEONARD, ASSOCIATE CHIEF, FOREST SERVICE, DEPARTMENT OF AGRICULTURE

Mr. DUNLOP. I will defer that, if I may, today, Senator.

Thank you very much, Mr. Chairman. I am accompanied today by Dale Robertson who is the Chief of the Forest Service, and by George Leonard who is the Associate Chief. As the Committee may know, both of these gentlemen have just assumed their positions this month, and we are very proud of them. They are both lifelong career civil servants who have done a marvelous job, and we have great expectations for them in the future.

I do have prepared testimony which we have submitted, and which I will further make available. There is a correction or two in it. If I may just proceed with some remarks that would highlight the remarks that we have submitted.

The CHAIRMAN. Thank you very much.

The Forest Service budget for fiscal year 1988 is very similar to last year's. It is slightly less than last year's appropriated level with reductions in the following areas: payments to counties; land acquisition; road construction; and State and private forestry.

So it is a pretty straightforward request. I just have a couple of questions.

First, the Forest Service Budget discounts almost all financial assistance to the States with the exception of pest management. Timber supply studies, most notably the recently completed Southern Study, show that we will become increasingly dependent on supply from nonindustrial private landowners, particularly in the South. These lands have been traditionally undermanaged and underutilized.

Could you explain how the discontinuation of assistance to the States will affect our ability to tap this supply?

Mr. DUNLOP. Yes, sir, I believe so. We have a broad policy objective of trying to de-emphasize those types of activities in the Forest Service and other areas of the Federal Government which amount largely to income transfers to the States. Many of these activities can indeed be carried out with State and local resources. We then hope to prioritize the amounts of monies that we have, and the amounts of monies we would request from the Congress to the highest priority items for which there is a unique and specific Federal role and ability to address.

That is why, as you have indicated, the pest management is a problem of acute concern for which the Federal Government has the expertise and the technical ability. In the others, the income transfers for other types of ongoing activities are simply that, and those resources can be raised at the State and local level, and indeed should be. We think the States should very much encourage the development of privately owned forests and woodlands.

The CHAIRMAN. I thank you, Mr. Dunlop.

Senator McClure?

Senator MCCLURE. Mr. Chairman, I wonder if we might hear from the other two gentlemen?

Mr. DUNLOP. Well, indeed, Senator, I did have some remarks I might make, myself, if I may, just as a quick overview.

Senator MCCLURE. Before asking questions, I would like to be able to hear from all three of you, if the other two have statements they would wish to make.

The CHAIRMAN. Yes, did you all have a statement? Did you want to make some further comments?

Mr. DUNLOP. Yes, sir, I have four points I think I would just like to highlight out of my testimony.

The CHAIRMAN. Yes.

Mr. DUNLOP. I will address some of the policy questions that are incorporated into our budget, and these gentlemen will address the specific details of the line items in the budget.

First of all of the policy areas, the first thrust of our budget proposal, as the Chairman has indicated, is pretty much the same type of ongoing program that we have had, except that we do have a significant reduction in the amount of monies that we request from the Congress. Our budget last year was appropriated to the tune of about $2.3 billion, and we would seek this year approximately $1.9 billion.

We are going to try to make the Forest Service operate with those reductions in funds by reducing payments to the counties, by changing the base upon which the payments to counties are made. We hope to be able to reform our land acquisition policies so that we can spend less money there.

We are undertaking a very aggressive effort to get our road construction costs down. We have requested some $30 million less in that account. And as Senator Johnston has indicated, we really do believe we do not need to be transferring monies directly to States just as a cash transfer, so we would have some reductions there.

I should point out that the activities of the Forest Service do generate significant revenue for the Federal Government, indeed to the tune of about $1.3 billion. So the net total cost of the Forest Service to the taxpayers is about $600 million. We are very proud of the fact that we carry on this tremendous responsibility with such a little bit amount of money that we are largely able to raise through sale of the valuable resources we have on the national forests.

I guess I should say that when we talk about our budget numbers and reducing spending, that we are proud of the fact that we are able to support a timber sales program of 11.1 billion board feet with that money, which is a very reasonable and yet very good level of timber supply for our Nation's growing economy.

Three other areas that I might mention that are policy movement for us involves, one, recreation user fees. The Administration will submit very soon a legislative proposal to give us expanded authority that meets widely accepted principles for making reasonable charges for recreation use on Forest Service lands where the Forest Service incurs a significant expense to provide and maintain highly developed facilities.

This is a modest proposal that would increase the revenues from user fees from about $16 million to $28 million per annum.

The second area of policy direction that we are trying to achieve in our budget submission is in the area of the net receipts in our payments to the States. As the Committee is aware, whenever the Forest Service removes timber from lands that are in counties, there is a provision in law that stipulates that we shall make payments to the counties that equal 25 percent of the gross. Like any other business enterprise, we do not really regard that as reasonable, and do believe that any expectation of receiving payments ought to come off of net, just like it would in any other enterprise.

We would point out that that would reduce the Federal outlays by some $250 million, while still providing significant payments to the counties in terms of about $26 million.

The third area that I might mention that is a policy directive for us is a relatively minor area, but it deals with something of very high significance to us, and that is marijuana eradication on the National Forests.

As the Senators are aware, we are having to deal with a new, highly organized and frankly violent and vicious criminal element growing marijuana. While we will continue our practice of working through local law enforcement people and trying to eradicate marijuana by pulling up plants, the fact of the matter is we cannot pull them up as fast as they can grow them, and we are left with an enormous amount of marijuana production on National Forests.

So we hope to be able to initiate through increased budget activity those types of law enforcement activities which would help us investigate these criminals, find out who they are, and get indictments and convictions and put them in jail where they belong.

The CHAIRMAN. Let me interrupt to ask how they can spot marijuana from the air? Does it have a distinctive color, or a distinctive look?

Mr. DUNLOP. Well, sir, I am informed that it has. I have never seen any of these plants, myself, but it is getting increasingly difficult to spot these plants because the new technology in marijuana production is that each of these plants can range in value—each plant—between $3000 and $7000. So the marijuana growers do not plant acre after acre. They will put 20 or 30 plants here, and 80 or 90 yonder, and 75 or 80 over here, and it is very difficult for us to spot them from the air.

This is one reason that they are making such an aggressive success in using the forests, because we just do not have the resources to identify where they are.

So what we believe we are going to have to do is go in and conduct surveillances and other types of criminal investigative activity to be able to spot the people that are carrying out this illegal activity.

With that, that would then comprise the policy areas that I would like to bring to the attention of the Committee.

[The prepared statement of Mr. Dunlop follows:]

STATEMENT OF
GEORGE DUNLOP
ASSISTANT SECRETARY
U.S. DEPARTMENT OF AGRICULTURE

Before The Senate Energy and Natural Resources Committee
Subcommittee on Public Lands, National Parks, and Forests

February 17, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I welcome the opportunity to appear before you today to discuss the fiscal year 1988 budget for the Forest Service. I am accompanied by Dale Robertson, Chief of the Forest Service.

Before Chief Robertson discusses the highlights of the Forest Service budget, let me discuss some of the policy issues this budget encompasses: (1) the need to reduce Federal expenditures, including those of the Forest Service, to help bring the deficit under control; (2) recreation user fees, and (3) a proposal to change payments to States to a net receipts basis.

Reducing Federal expenditures

The President and the Congress through passage of the Gramm-Rudman-Hollings Act have emphasized the need for continuing steady reductions in the deficit by limiting government spending and encouraging economic expansion, and the Forest Service budget will help do both.

The proposed budget authority for the Forest Service of $1.9 billion is less than the $2.3 billion appropriated for FY 1987, with the reduction primarily in 4 areas--payments to counties, land acquisition, road construction, and State and private forestry. Because many of the funded programs generate revenue, this budget will return estimated receipts of $1.3 billion, leaving a net deficit of only about $600 million.

Also, Forest Service programs are funded at purposeful levels of investment that will help foster long-term economic growth and maintain environmental quality. The budget provides an 11.1 billion board feet timber sale program with sufficient funding to do a quality job on the ground. Most other resource management programs are maintained at or near past levels.

The productivity of Forest Service programs will continue to be improved by carefully controlling costs, adjusting management procedures, and paying close attention to benefit-cost relationships. Careful attention will be given to both market and nonmarket values of resources, such as water quality, and their associated costs.

Receipts generated from lands managed by the Forest Service are expected to be about $1.3 billion, compared to $1.2 billion estimated for 1987. This slight increase in receipts reflects both an improving economy and efforts of this administration to bring the American people a financial return from the public lands.

Recreation user fees

In regard to financial returns, we are proposing expansion of the Forest Service's recreation fee authorities.

The Department of Agriculture strongly supports providing outdoor recreation opportunities for the public. In 1985, the National Forests provided 42 percent of the recreation visitor days provided on all Federal lands, more use than provided by any other Federal agency. Yet, it has become increasingly expensive to provide the high quality public recreation opportunities, facilities, and services that Americans want and deserve. We believe that the actual beneficiaries--users of these recreation facilities and services--should pay a higher percentage of the costs of the facilities.

To accomplish this, we will soon transmit to the Congress proposed legislation to (1) promote the availability, maintenance, and use of high-quality recreation areas and facilities in the National Forest System for use, enjoyment, and benefit of all Americans; (2) require persons using recreation facilities and services to pay an appropriate share of the cost of providing and maintaining those facilities and services; and (3) increase the sources of funding for operating National Forest Systems recreation areas and facilities by using the revenue from recreation receipts to enhance recreation areas, facilities, and services.

Proposed payments to States legislation

As in our 1987 proposal, the 1988 budget proposes to change the basis for payments to States from a sharing of gross receipts to a sharing of net receipts. The Forest Service would deduct from receipts the costs of administering the programs that generate those receipts, except for recreation costs. After these related costs are deducted, twenty-five percent shares of these net receipts will be paid to State or county governments.

The primary reason for this proposal is that current law distributes 25 percent of gross receipts without taking into account the cost of producing these receipts. In some cases receipts do not cover the cost of production. Further, receipts sometimes are not cash revenues, but are credits, such as purchaser road credits and Knutson-Vandenberg collections. In effect, the Federal government bears all the costs while the State and local governments reap a disproportionate share of the benefits. It is only sound business practice to deduct costs from gross revenues before sharing profits.

Mr. Chairman, this concludes my opening remarks. Mr. Robertson will now discuss details of the FY 1988 budget.

Forest Service

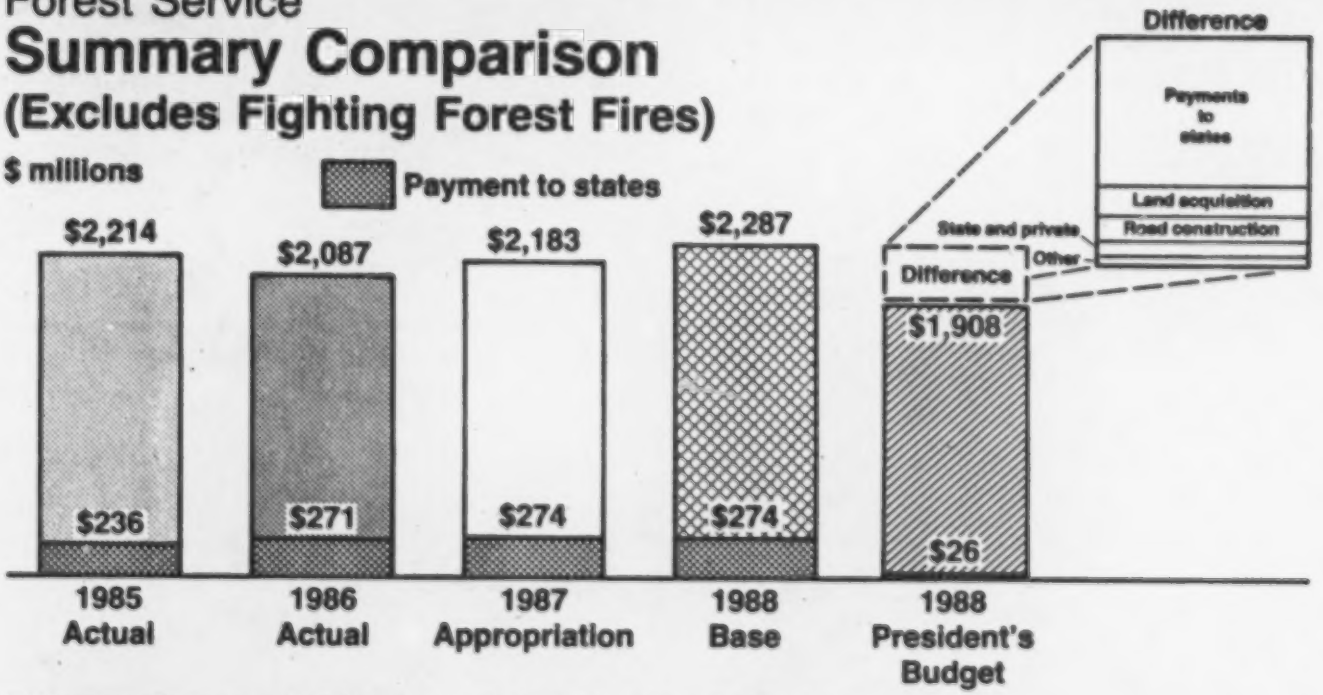
Major Considerations

- Reduce budget deficit
- Increase receipts to the Federal government
- Improve Forest Service efficiency
- Maintain productivity and environmental quality on National Forest System Lands
- Respond to high level of demand for wood products
- Provide research backup for future resource and technology needs
- Cooperate to help fulfill state and local responsibilities for resource protection
- Complete land management plans reflecting balanced programs
- Implement land management plans within available funds

Forest Service

Summary Comparison

(Excludes Fighting Forest Fires)



Difference between 1988 base and 1988 President's Budget:

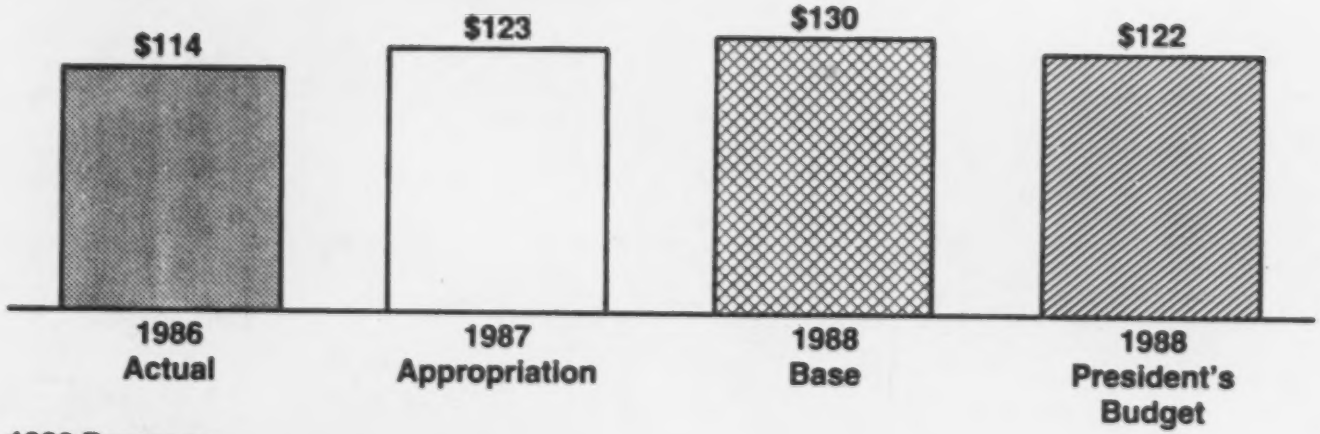
- -247.8 Payment to states
- -48.6 Land acquisition
- -40.4 Road construction
- -25.3 State and Private Forestry
- -16.5 Other

Forest Service

Research

(shown without competitive grants)

$ millions



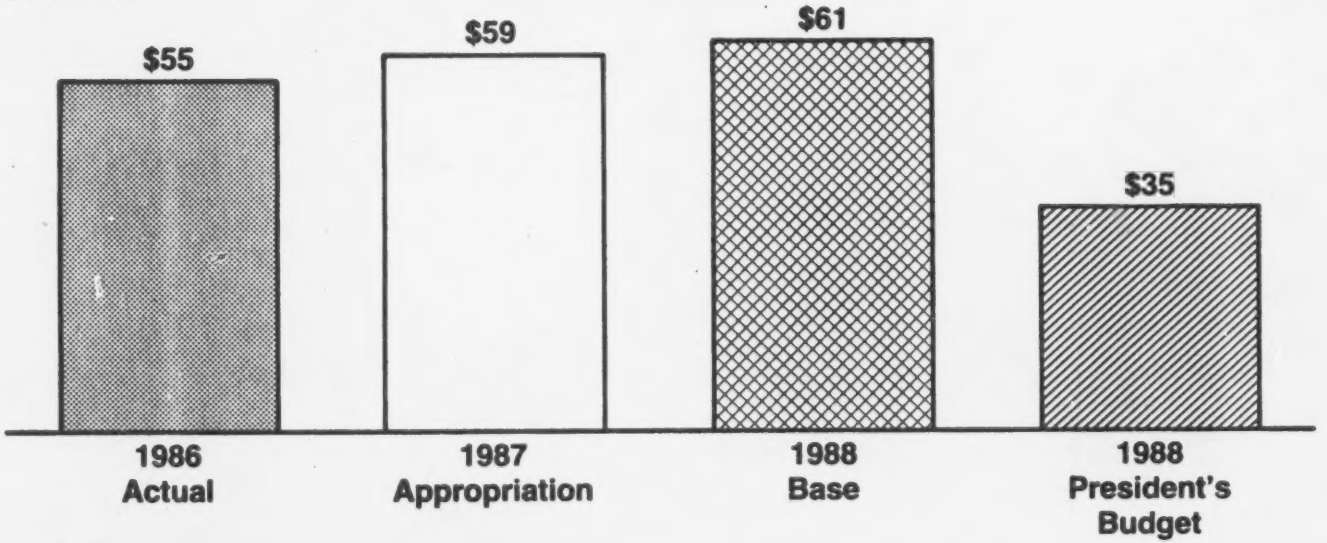
1988 Program:
A sustaining core program in:

- Timber management
- Resource protection
- Resource inventory and analysis
- Forest economics
- Watershed management
- Forest products and harvesting
- Wildlife, fish, range, and recreation management

Forest Service

State and Private Forestry

$ millions



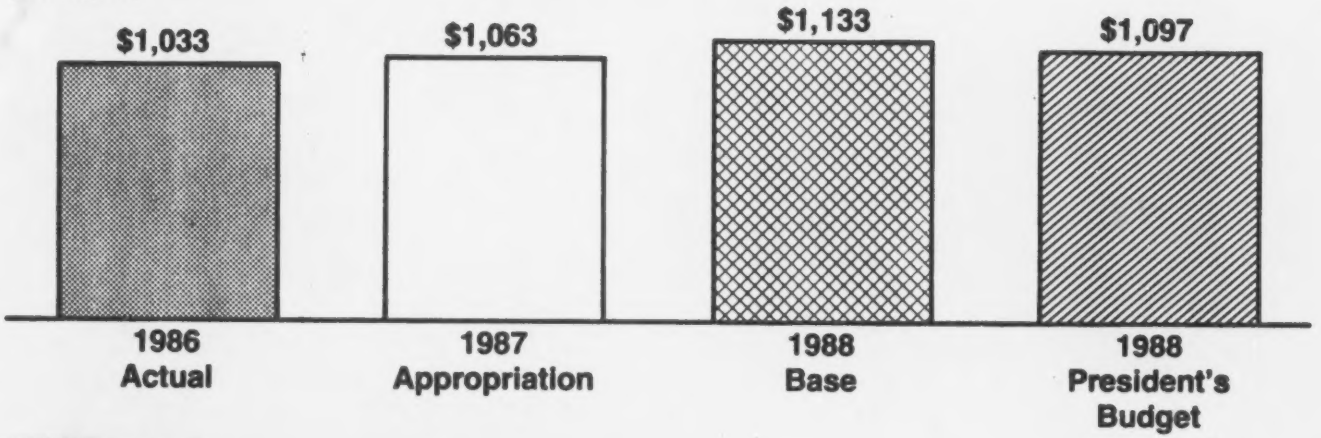
1988 Program:

- **Forest pest management on Federal lands**
- **Special projects (BWCA)**
- **Technical assistance for pest management and fire protection**

Forest Service

National Forest System[1]

$ millions



1988 Program:

- **Maintain productivity and environmental quality**
- **Timber sales (11.1 BBF)**
- **Minerals**
- **Recreation ($52 million in proposed receipts account is included above for comparability.)**

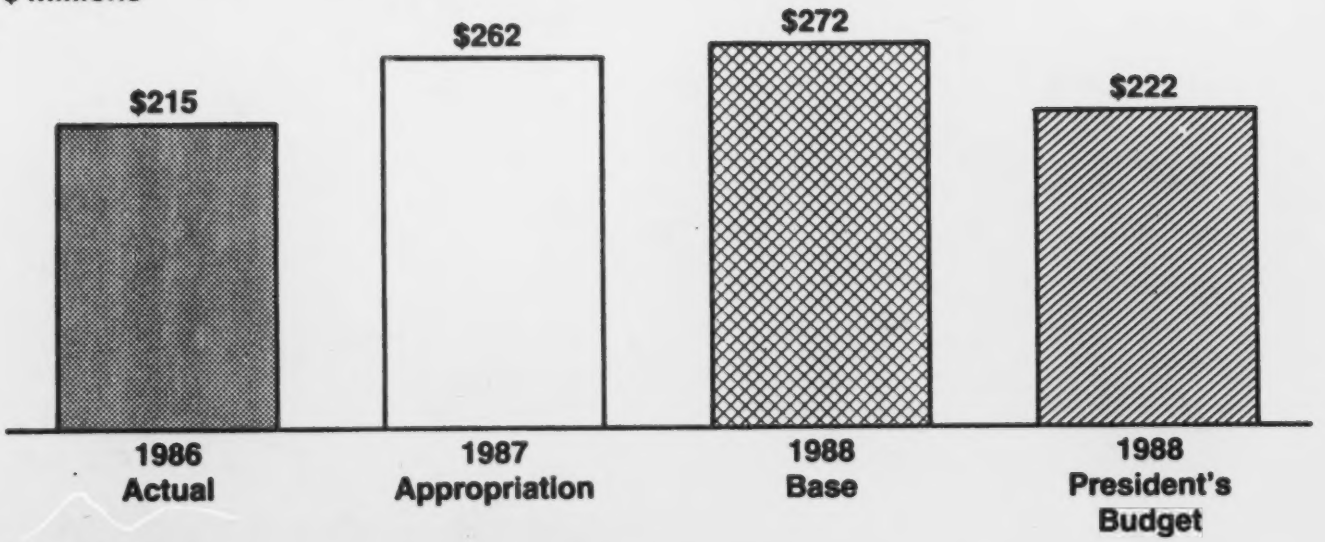
[1]**Includes Reforestation Trust Fund and excludes Fighting Forest Fires for consistency.**

Forest Service

Construction

(Excludes Timber Purchaser Credit Program)

$ millions



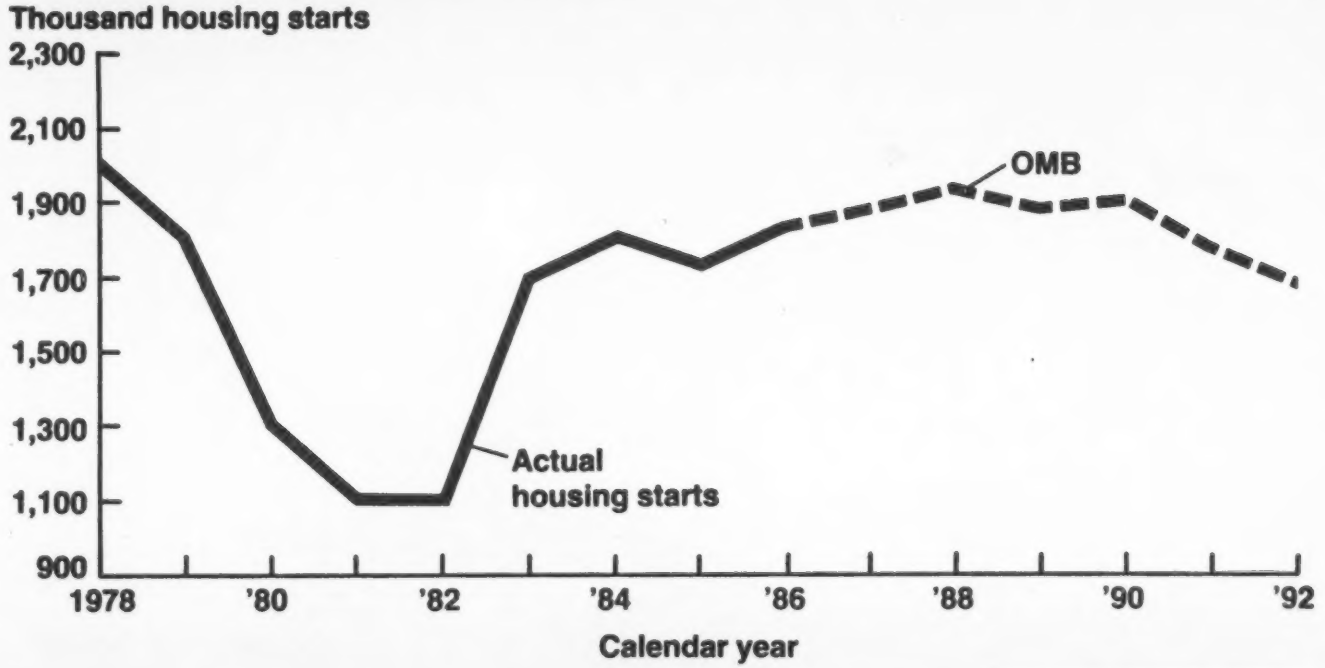
1988 Program:

- **Access for timber sales and resource management**
- **Critical support facilities, particularly health and safety**

Forest Service

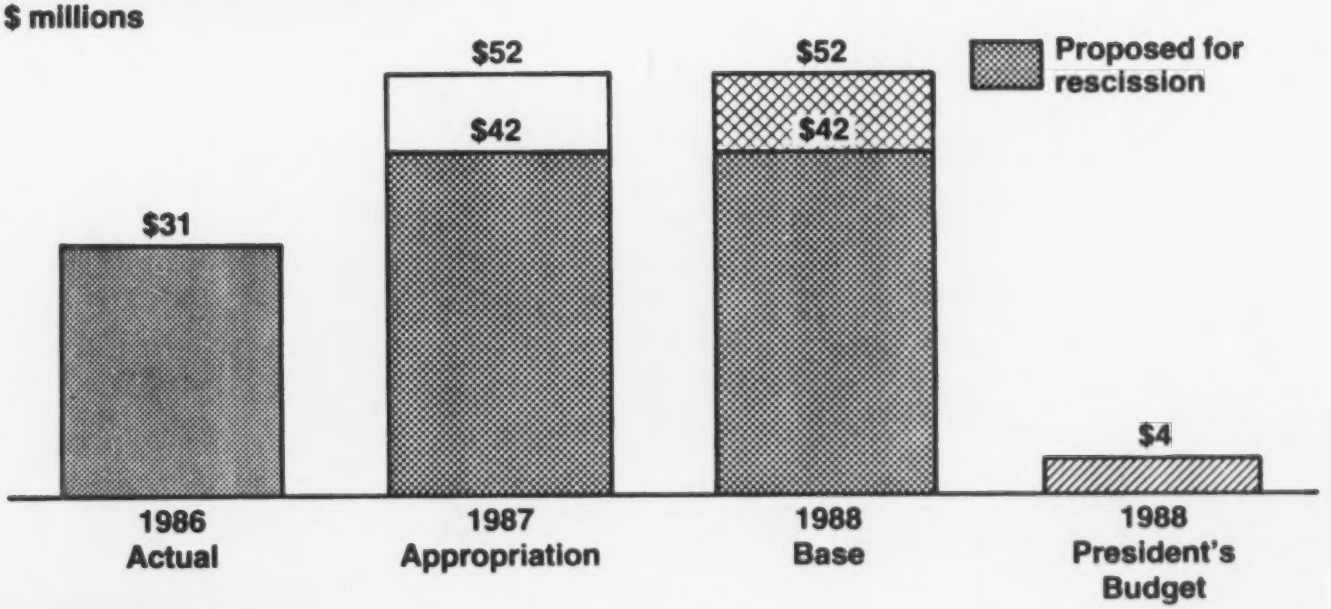
Private Housing Starts 1978-1992

Annual-Actual or Projections



Forest Service

Land Acquisition

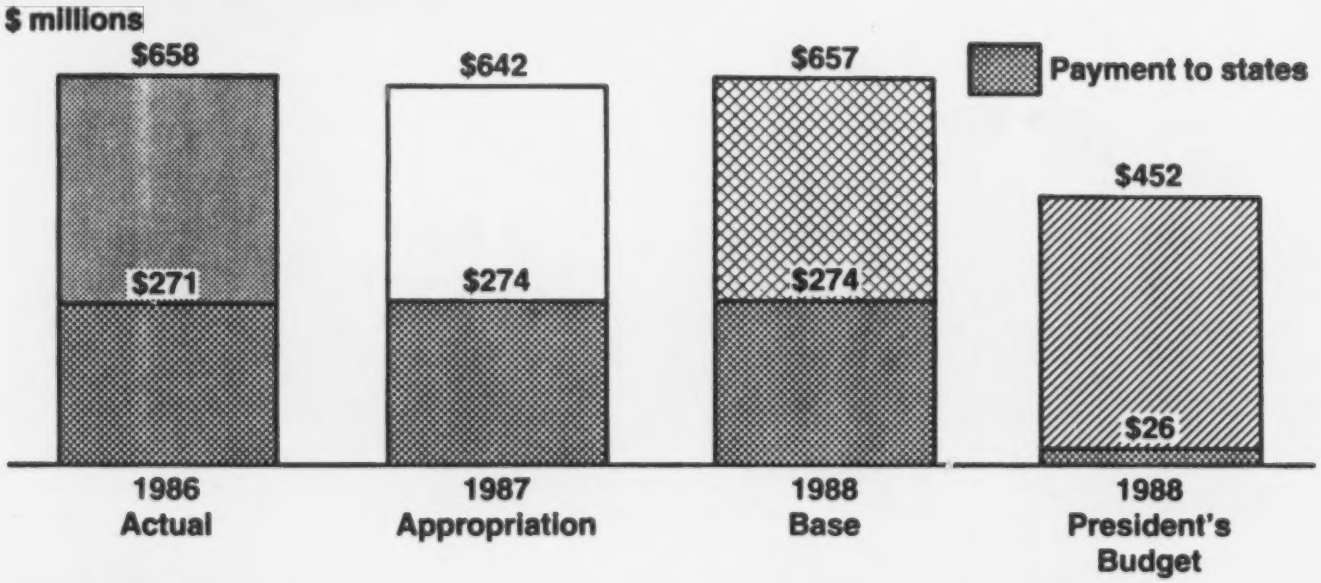


1988 Program:

- **Closing existing L&WCF cases**
- **No new purchases**

Forest Service

Permanent/Trust Funds

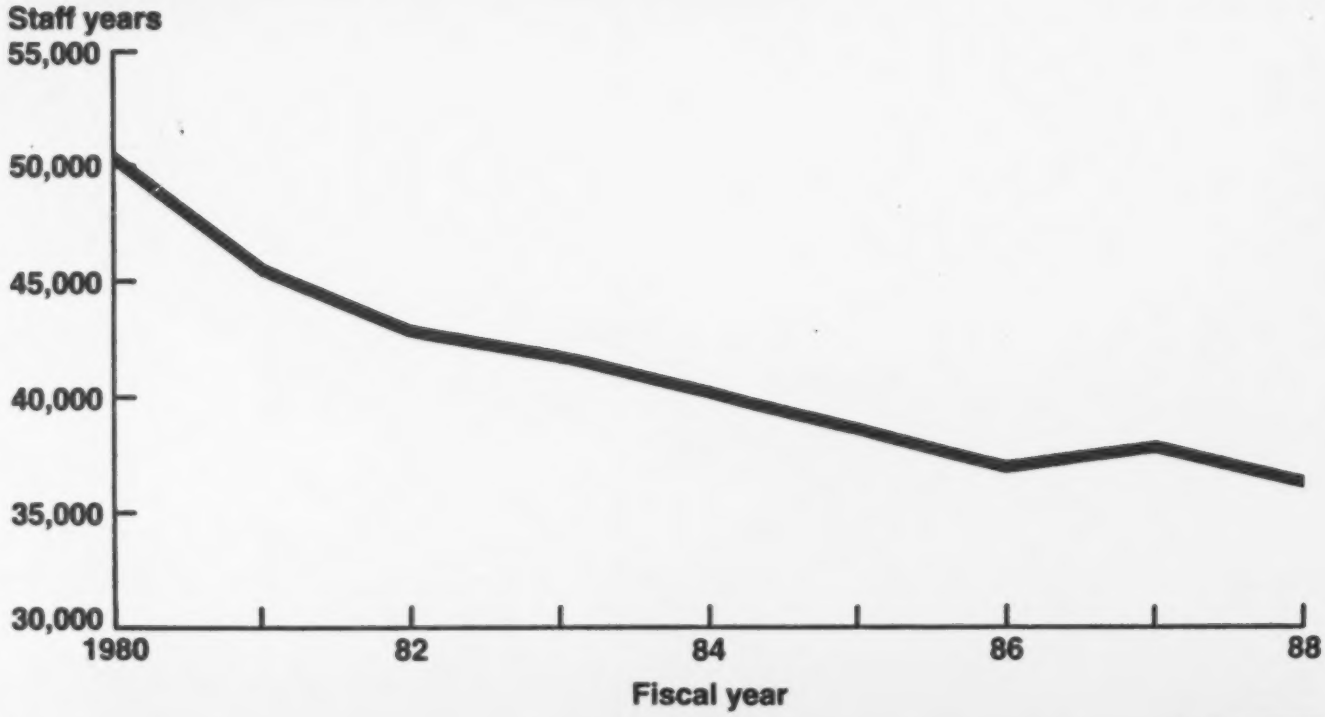


1988 Program:

- Timber Salvage Sales
- Tongass Timber Supply Fund
- Brush Disposal
- KV Reforestation and Timber Stand Improvement
- Payments to States on a net receipts basis

Forest Service

Staff Year Trend 1980-1988



Mr. DUNLOP. Now, Dale Robertson, Chief of the Forest Service, would like to go over some of the specific items in the budget that we believe are of special interest to the Committee.

STATEMENT OF HON. F. DALE ROBERTSON, CHIEF, FOREST SERVICE, DEPARTMENT OF AGRICULTURE

Mr. ROBERTSON. Mr. Chairman, I will just highlight some of the major points on some of our major programs.

First, Forest research. The proposed funding for research is $122 million, which is about 5 percent less than fiscal year 1987, but most of this reduction is due to the elimination of competitive research grants. This budget will permit us to continue the high-priority research in the areas that we are currently doing research in.

Assistant Secretary Dunlop has already talked about the State and private Forestry program which does eliminate most of the financial assistance to the States except for the State of Minnesota as it relates to the Boundary Waters Canoe Area.

In the case of the National Forest System, the proposed funding is just a little over $1 billion. After adjusting for the Forest fire fighting expenses and the proposed use of recreation fees to operate and maintain recreational facilities, this is about 3 percent more than we had in 1987.

Again, the budget proposes the use of about $52 million of recreation user fees to be used to finance the operation and maintenance of recreation areas on the National Forests, and this would offset the regular appropriated funds for recreation. When you consider both funding sources together, the recreation program will be funded at about the same level as fiscal year 1987.

In the case of the fish and wildlife habitat management program, our first priority is to do a good job in planning and coordinating with other resource activities such as timber sales and road building in order to minimize adverse effects and to take advantage of opportunities to gain fish and wildlife benefits. The investments in habitat improvement work through appropriated dollars will be reduced, but will be directed at highly productive projects and threatened and endangered species.

I might say that much of this reduction in appropriated funds will be offset by using KV, Knutson-Vandenberg money from timber sales to do fish and wildlife habitat improvement projects.

In the case of forest fire protection, the presuppression activities and the fire fighting forces will be maintained at about the same level as fiscal year 1986. We will continue to rely on the use of fire fighting crews of States and other agencies in emergency situations, as this has worked out very well over the past two years.

In our timber sale program, the proposed funding, including all support costs except purchaser credit road construction, is $480 million. We anticipate receipts of about $800 million. This will provide a timber sale level of 11.1 billion board feet, compared to 11.2 billion board feet in 1987. The harvest level for 1988 is projected to be 11.8 billion board feet, which is about the same as the actual harvest in 1986.

Funding for the appropriated forest road construction is $198.6 million, about $30 million less than 1987. The level of purchaser

credit and purchaser-elect road construction is estimated at $129 million. All together, this will finance construction of about 3000 miles of new road, and the reconstruction of about 4600 miles of existing roads.

I would like to emphasize, Mr. Chairman, that the 1988 road construction program provides access for timber sales, and it is timber sales roads that will respond to immediate timber sale needs. And the timber sale program and the forest road construction program are in balance. One cannot be adjusted without a corresponding adjustment in the other, and the proposal reflects a strong emphasis on reducing road construction costs by building the minimum road needed to meet land management objectives.

Finally, I would like to briefly highlight the points in our land acquisition budget, a proposed budget of $3.9 million, to basically close existing cases. No new acquisitions are proposed under this budget through purchase. However, land exchanges will be relied upon to acquire high-priority tracts.

For fiscal year 1987, the Administration is also proposing to rescind $49 million of land acquisition funds and to transfer an additional $27 million to various appropriations to cover the additional cost of the Pay Act and the new Federal Employees Retirement System.

Mr. Chairman, that highlights some of the key points on our program. At this point, I would be happy to respond to questions.

We do have a brief summary, which basically shows that our budget is about $400 million below fiscal year 1988, but it is predominantly in four areas: payments to States; the land acquisition; the road construction; and the State and private forestry program's financial assistance to the States.

[The prepared statement of Mr. Robertson follows:]

STATEMENT OF
DALE ROBERTSON, CHIEF
FOREST SERVICE
U.S. DEPARTMENT OF AGRICULTURE

Before the Senate Energy and Natural Resources Committee
Subcommittee on Public Lands, National Parks, and Forests

February 17, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I welcome the opportunity today to discuss the FY 1988 budget for the Forest Service.

FY 1988 budget

The 1988 budget request for the Forest Service is $1.9 billion. At this proposed funding level, we will continue to emphasize high priority research and provide a reasonably balanced resource management program on the National Forests and Grasslands. States will be expected to assume more of their responsibilities for forest management assistance on non-Federal lands. We will further streamline our organization and programs to reduce costs and increase efficiency, while maintaining a suitable level of resource management and service to the public.

Forest research

The proposed funding for forest research is $122.2 million, or about 5 percent less than was appropriated for 1987. This funding will permit us to focus research into high-priority areas, including research initiatives in the effects of acid deposition, international trade, biotechnology, critical wildlife/timber relationships, the wildland/urban interface, and southern forest productivity. The lowest priority research will be terminated and some other research stretched out, but we will continue to carry out important research work in all of our programs.

State and private forestry

The budget includes $35.4 million for Forest Service State and private forestry programs, about 40 percent less than was appropriated for 1987. The primary emphasis with this funding will be on pest management on Federal forest lands. Except for the cooperative pest action program and funding to Minnesota for intensive management associated with the Boundary Waters Canoe Area wilderness legislation, financial assistance to States will be discontinued.

National Forest System

Proposed funding for the National Forest System appropriation in 1988 is $1,016.4 million. After adjusting for the requests for forest fire fighting expenses and for operating and maintaining recreation facilities, this is about 3 percent more than was appropriated for 1987.

The request includes only $1 million for fire fighting in FY 1988, which will be followed by a supplemental request after the fire season to

reimburse actual costs, compared to the $125 million initially appropriated for this function in FY 1987.

Recreation use

The request also proposes to transfer $52 million in proposed budget authority from the recreation program into a proposed new special fund for operating and maintaining recreation facilities with money generated from recreation receipts. This proposal would return receipts to the Forest Service, to reduce regular appropriations needed to pay for operating and maintaining Forest Service recreation areas and facilities.

Considering both funding sources, the $116.3 million recreation program in FY 1988 is slightly more than the FY 1987 appropriated level, and sufficient to adequately meet the recreation demands we are experiencing on the National Forests.

Wildlife and fish habitat management

Funding proposed for wildlife and fish habitat management in 1988 is $37.9 million.

Our priority in habitat management is to do a good job in planning and coordinating with other resource activities, such as timber sales and road building, to minimize adverse effects and take advantage of opportunities to gain fish and wildlife benefits. Investments in habitat improvement work will be directed at high productivity areas and threatened and endangered species in the most critical situations.

Forest fire protection

Proposed funding for fire protection is $151.6 million. Fire presuppression activities and fire fighting forces will be maintained at about the same level as in FY 1986. We will continue to rely on the support of States and other agencies in emergency situations, as this has worked quite well.

Timber sale program

The proposed funding for the timber sale program, including all support except purchaser credit road construction, is $479.9 million. This will provide a timber sale level of 11.1 billion board feet, made up of 7.3 billion board feet of timber in new sales, 2.7 billion board feet of reoffer volume as a result of the Federal Timber Contract Payment Modification Act of 1984, 781 million board feet of salvage volume, and 374 million board feet from the Tongass National Forest. The harvest level for 1988 is projected to be 11.8 billion board feet, reflecting an increase in harvesting from the 11.5 billion board feet projected for 1987.

Reforestation and stand improvement

Altogether, with appropriated, trust, Tongass, and Knutson-Vandenberg funds, the budget proposes $219.3 million for reforestation and stand improvement work. This is about 3 percent more than appropriated for 1987.

Within this, $141.3 million is proposed for reforestation, sufficient to reforest about 363,100 acres. Investments in reforestation will be

deferred on some acres not associated with timber sales and where there are little or no environmental effects.

Forest road construction

Funding for appropriated forest road construction is $198.6 million, about $30 million less than appropriated for 1987. The level of purchaser credit and purchaser elect road construction is estimated at $129 million. Altogether, this will permit construction of about 3,008 miles and reconstruction of 4,601 miles. This totals about 60 fewer miles than projected for FY 1987.

The 1988 road construction program will emphasize access for timber sales, with roads that respond to immediate project needs. The timber sale program and the forest road program budgets are in balance, and one cannot be adjusted without a corresponding adjustment in the other. We will continue a strong emphasis on reducing road construction costs by building to the minimum road standard needed to meet the immediate land management objective.

Cooperative law enforcement

The budget for cooperative law enforcement in 1988 is $5.7 million. This includes $3.2 million for drug control, which will be used by the Forest Service to detect and investigate illicit Cannabis cultivation and to apprehend and prosecute major commercial growers. The remaining $2.5 million will be provided to local law enforcement agencies for cooperative efforts on the National Forests. Of these cooperative funds, $2 million are for Cannabis eradication and $500,000 for extra protection of the public and of property in high risk areas on National Forests.

Land acquisition

The budget proposes $3.9 million to close existing cases. No new acquisitions are proposed at this time. Land exchanges will be relied upon to acquire other high-priority tracts. For fiscal year 1987, the Administration is also proposing to rescind $49 million, and to transfer an additional $27 million to various appropriations to cover the additional cost of pay and the new Federal Employees Retirement System.

This concludes my prepared testimony. I will be glad to respond to any questions.

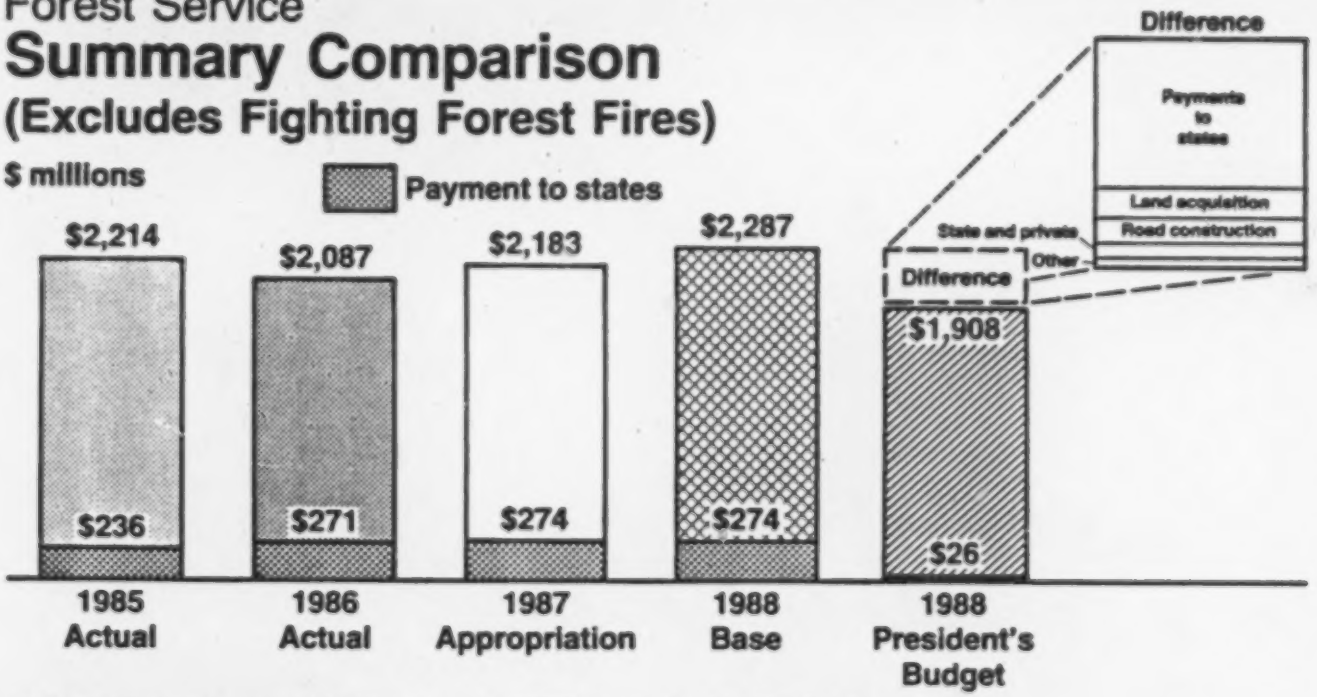
The CHAIRMAN. Did you have any further presentation?

Mr. DUNLOP. No, sir. I would point out that we did show a visual of our budget for the use of the Committee.

Forest Service

Summary Comparison

(Excludes Fighting Forest Fires)



Difference between 1988 base and 1988 President's Budget:

- -247.8 Payment to states
- -48.6 Land acquisition
- -40.4 Road construction
- -25.3 State and Private Forestry
- -16.5 Other

Mr. DUNLOP. I would emphasize once again that we feel we can carry out the mission of the Forest Service with the funds that we've requested, and that we can do so at substantial reduction in the budget request that we have had over fiscal year 1987.

The CHAIRMAN. Senator McClure.

Senator MCCLURE. Thank you very much, Mr. Chairman.

First, I want to welcome a couple of men here who are here in their new capacities. I think it is the first appearance of Chief Robertson and Deputy Chief Leonard. Mr. Dunlop has been here before in this capacity, but I do want to note what is, for professional Forest Service personnel, the peak of a career. I would congratulate you, Chief, for your appointment, and welcome you here today.

Mr. DUNLOP. Thank you.

Senator MCCLURE. Obviously there are a number of us who are very much concerned about the Administration's proposal again this year to change the distribution of receipts from a gross-to-net basis. I know that you are as familiar with the evolution of that problem as anyone can be. And I assert, it is a problem as long as the government wants to go back to what they were doing before we had to correct it by statute when we went from net to gross by statute.

It had been gross in the beginning, and it gradually was eroded over the years to net by increasing allocation of costs to purchases, and eventually there was very little net left to distribute to the States. Congress went back and said, no, you cannot do that. "Gross" means gross, we said so. The Administration has ever since that time been trying to undo what Congress did.

Mr. Dunlop, has the Department done any study of the impact on the States and their dependence on timber of what would happen if we did do what the Administration estimates here?

Mr. DUNLOP. Senator, I would ask the Chief to respond in detail to that, because I do not know of any specific study we have done. But I do know that any time we engage in a forest management practice or any activity of this sort that would affect our neighbors, indeed we take into consideration those facts and those figures as a matter of principle.

Our hope in being able to achieve this objective is not to run counter to the obvious and intentional direction of Congress. Indeed, we submit this as part of our budget and for your consideration. We are not just going ahead and doing this.

Senator MCCLURE. I understand you are not trying to violate the law. You are trying to get the law changed.

Mr. DUNLOP. Yes, sir. And simply, that is just a consideration of the fact that we have an enormous Federal deficit. Most of the States do run surpluses, and we have just got to grapple with the different ways in which we can reduce spending.

Senator MCCLURE. Well, from your standpoint, in your estimation it is a deliberate attempt to shift the burden from the Federal Government to State government?

Mr. DUNLOP. Well, sir, shift the burden might be an appropriate term from one perspective. But very frankly, looking at any normal accounting practice—take a private corporation, General Motors or some firm like that. They do not distribute their dividends on the basis of gross sales. They do it on the basis of net.

Senator MCCLURE. I am sure glad you mentioned that. How much taxes do you pay on that land you own? Tell me what they are on the two-thirds of my State that is owned by the Federal Government?

Mr. DUNLOP. I understand where you are coming from, Senator. I do not know the answer.

Senator MCCLURE. How much tax does General Motors pay before they distribute net?

Mr. DUNLOP. Well, I do not know that exactly, either.

Senator MCCLURE. When you start paying taxes, then come and tell me about how government operates versus private industry.

Mr. DUNLOP. Yes, sir, I understand your perspective on it. We are just looking at the bottom line and trying to come up with ways to——

Senator MCCLURE. Which bottom line?

Mr. DUNLOP. Well, the Federal deficit right now.

Senator MCCLURE. All right. Your responsibility is to the Federal Government? You have no responsibility to the State governments, no responsibility to the communities involved, and no responsibility to the people who are affected by it, is that correct?

Mr. DUNLOP. No, sir, I would not say that. I think we feel a very deep sense of responsibility.

Senator MCCLURE. Well then, look at that bottom line a little differently.

Mr. DUNLOP. I understand, Senator.

Now, Dale, would you care to respond to a specific analysis—[laughter].

Or have you pursued that?

Senator MCCLURE. No, I just wanted to know if you had really analyzed the impact other than just say generally speaking, gee, somebody else is going to have to pick up this burden. You do not want to call it a burden. Somebody else is going to have to pay the bills that this money paid for.

Have you really looked at that? You said, yes, we considered that. You did, you just now said so.

Mr. DUNLOP. Yes, and——

Senator MCCLURE. But have you considered it any more than that?

Mr. DUNLOP. Well, I think that is the question I would prefer Dale to answer, have we considered this in the specific county by county and State by State basis.

Mr. ROBERTSON. Senator McClure, we have looked at sample counties as to what this—how this would affect them. But it is not hard to determine the effects. This proposal would reduce the payments to the States by about 90 percent, go from $274 million to $26 million.

And this $26 million would be distributed in those counties where we have national forests that turn a profit. So that means on many of the national forests there would be no receipts shared with the counties. And this would be primarily the very productive States of Oregon, Washington, California, and some of the southern States and a few others.

Senator MCCLURE. Did you look at Shoshone County, Idaho?

Mr. ROBERTSON. I doubt that that was one.

Senator McCLURE. It is a timber county. It also used to have some mining in it, lead, zinc, and silver. It had a smelter until the smelter closed down, throwing 4,500 people out of work.

One hundred percent of the county's road budget is timber receipt money, 100 percent of it. It has the highest unemployment in my State, one of the highest unemployment rates in the United States. And you suggest it is equitable, Mr. Secretary, to transfer the load of the road program in Shoshone County, Idaho, from the Federal Government to the State government?

Mr. DUNLOP. Well, sir, of course what I am addressing in my capacity here is should we be running these income transfers through the Forest Service budget. If the Federal Government decided it wanted to assist States in running its operations, then maybe that would be appropriate.

Senator McCLURE. Well, why do you not just deed the land to the State, then?

Mr. DUNLOP. Well, that would be an interesting proposition.

Senator McCLURE. Are you in favor of that?

Mr. DUNLOP. Well, I think in some instances it might be appropriate, but Congress has directed us specifically against being able to do that kind of thing.

Senator McCLURE. And they have directed you specifically again on the division of gross receipts?

Mr. DUNLOP. Yes, sir, they have. We are carrying out the law, for sure.

Senator McCLURE. Yes, I understand that. But I really would invite you to take a look at the impact that it has. Do you know where this money goes, Mr. Secretary? Where does the money in timber receipts go?

Mr. DUNLOP. Well, schools and roads is the account. It is directed to the counties for the use of those purposes.

Senator McCLURE. I do not know about your State, but my State has a little trouble paying its budgets now. Seventy-eight some percent—I have forgotten the exact fraction—of the State budget, but over 70 percent of the State budget goes to education.

Mr. DUNLOP. Yes, sir. And of course, one of the things we are real encouraged about is the economic activity that takes place on our national forests to generate jobs and revenue and all kind of activity that can be appropriately taxed.

Now, in some of these counties where the overwhelming presence of the Forest Service is about the only way they have any income, I understand exactly what you are saying.

Senator McCLURE. Custer County, Idaho, is 93 percent Federally owned.

Senator FORD. It does not have any tax base.

Senator McCLURE. It has a little tax base, and we are grateful for the fact that the Forest Service has an office there and those people are residents and they live there and they support local businesses. That is helpful, but it does not pay the bills. It helps.

I emphasize that, because it seems to me that the Federal Government, looking at this problem, is kind of glossing over the impact it has upon local communities. When you see a community like Shoshone County, that has absolutely no budget except for this item for the maintenance of its roads and an important contribu-

tion for the schools, that just there is not any ability in that county to absorb the loss which would come about as a result of this change.

Mr. DUNLOP. Well, perhaps, Senator, the committee would be willing to look at this proposal we have, which is one slice of our budget, and come up with a way that maybe we could accommodate all these concerns. You know, oftentimes when government tries to address issues they take the worst case scenario and then apply it uniformly to the whole country.

And perhaps there is some way that those concerns that you are describing could be addressed by the committee and yet also reduce the total Federal outlays in this area.

Senator MCCLURE. Well, I think the Chief indicated it would reduce the payments to the States by 90 percent.

Mr. DUNLOP. In some counties, that would have an extremely adverse impact. And in other counties, it would just be adverse.

Senator MCCLURE. A loss of 90 percent of the funds that they get is only adverse?

Mr. DUNLOP. Well, in some counties, yes, sir, because they have more economic activity going on, that that would be less significant.

Senator MCCLURE. Well, you have some counties that you have in mind that I do not have in my State, because the timber counties, where the timber receipts are a large part of their income, where the adverse effect would be at all large, are counties in which there is very little other economic activity.

By nature, where the Federal Government is dominant, they are dominant. Where they have timber lands, they have timber lands, and there is nothing else there.

The forest industry is going through an evolution, as I think everyone knows, of modernization of their mills and centralizing their mills. The result is there are fewer small mills in small communities, and even where the mills are located the modernization reduces the number of people that work there.

Those communities are in trouble. We had a downturn in timber supply, we had a downturn in lumber demand, we had an upturn in imports from Canada. We have all kinds of adverse effects in timber counties, and they are among the most depressed counties in the United States.

And I see the Federal Government coming along and suggesting now that somehow those counties are so flush they can withstand it. And yes, I am concerned about the Federal Government and its deficit, but I do not think you can do it on the backs of some of the poorest counties in the land.

If we were to start setting any kind of priorities, I do not think you would set it this way. Now, if the Federal Government really wanted what you suggest as an alternative—you were proposing to us in conjunction with this that we divest the Federal Government of ownership of all of this land and transfer it to the States—you might find me an enthusiastic participant in that action.

But I will be far less enthusiastic about your attempt to beggar the States in order to help the Federal Government's deficit.

I have some other questions that I want to ask, but I will allow the others to go ahead of me.

Senator FORD. I am about ready to give you my time.

Senator MCCLURE. I have not gotten into tobacco.

Senator FORD. Just stay on timber. They sound like tobacco problems.

Senator MCCLURE. Before going further, I would like to ask unanimous consent that a statement by Senator Hatfield be placed in the record at this point.

The CHAIRMAN. Without objection.

Senator MCCLURE. Needless to say, it starts out in the same vein I have been pursuing.

[The prepared statement of Senator Hatfield follows:]

SENATOR MARK O. HATFIELD
STATEMENT ON THE PRESIDENT'S PROPOSED
FY 1988 BUDGET
COMMITTEE ON ENERGY AND NATURAL RESOURCES
FEBRUARY 17, 1987

Mr. Chairman:

I appreciate having the opportunity to present my concerns regarding one particular portion of the Administration's budget proposal which would be devastating to my home state of Oregon. Once again, the President has included a provision whereby the formula for distributing national forest timber sale receipts to local governments would be altered by basing the payments on net receipts instead of gross receipts. Specifically, the Administration would like to deduct from the gross receipts the expenses incurred by the Federal Government in managing the resources before sharing them according to current formulas with state and local governments.

It evidently is necessary to remind the Administration that the current receipt-sharing program was instituted to help states and local governments by providing support for the associated costs incurred in the development of natural resources on federal lands, and to offset the lands' nontaxability by counties and school districts. The money received by the local governments is not used frivolously. These funds can be used only for public

schools and roads. Many of Oregon's school districts currently are facing financial difficulties of tremendous proportion. While these problems are not a result of the Federal Government's policies, a reduction in timber receipt payments would only make an already bad situation worse. Likewise, a reduction in the funds used for road maintenance would place an unnecessary burden on counties, whose need for these funds is a direct result of the Federal Government's timber sale program. Any attempt to reduce the amount of these payments to local governments runs contrary to the Congress' original intent. In light of the current poor economic situation in Oregon, the need for the existing program to continue in its present form is an absolute necessity.

Like other Western states, a significant portion of Oregon's land base (52 percent) is owned and managed by the Federal Government. This degree of federal control places obvious restrictions on local governments with regard to their opportunities to raise operating revenue. The timber receipt payments program represents the fact that the Federal Government acknowledges this relationship with the localities, and that it is willing to compensate the states adequately for the generation of federal revenue from this land. Accordingly, it would be a cruel blow indeed for the Federal Government to abruptly renege on this longstanding commitment, upon which local governments depend for a reliable source of funds.

The Association of Oregon Counties estimates that the enactment of this proposal would result in an approximate 50 percent reduction in federal timber sale payments to Oregon counties and school districts. Nationwide, this proposal would reduce payments to states by approximately $250 million. Such a dramatic reduction in payments would place even more fiscal baggage on local governments already burdened with a lingering resessionary economy.

It is my hope, then, Mr. Chairman, that this Committee would handily reject any legislative initiatives that may be introduced in the 100th Congress which would alter the current national forest timber sale receipt-sharing formula.

Senator MCCLURE. And some questions by Senator Domenici with respect to the impact upon New Mexico with respect to forest receipts, if we could place those in the record for responses.[1]

The CHAIRMAN. Without objection.

Senator MCCLURE. Senator Melcher has to go preside. Senator Melcher.

Senator MELCHER. Thank you, Mr. Chairman.

George, this idea of somehow not paying the States or counties the same amount of money they paid before is really an idea of OMB, is it not, just like some other things in the Department of Agriculture's budget is in there, because of OMB?

Mr. DUNLOP. Yes, I think that is safe to say. But, you know, the Forest Service prides itself on the relationship it has with its neighbors in the States and counties, and we recognize the impact these things have.

Senator MELCHER. So you really do not expect us to go along with it, do you?

Mr. DUNLOP. Well, sir, somehow the Administration and the Congress together have got to meet the Gramm-Rudman $8 billion number. Somewhere along the way, we will have to make some decisions we otherwise would not prefer to make.

So certainly we ask you to keep it under your most earnest consideration.

Senator MELCHER. It is like passing the cost of meat inspection away from the Department of Agriculture on to the packing plants and chicken processors. You really do not expect us to do that, either, do you?

Mr. DUNLOP. Well, that is beyond my area of expertise, but I understand there is a strong objection to that as well.

Senator MELCHER. Oh, no, you know all about that, George. Do not kid me.

There are lots of things in this budget that are just in there, you know, if we did it would probably cause more problems for the Department of Agriculture and would require statutory changes. So we will do the right thing by the Department of Agriculture by ignoring them and then finding cuts in other places.

Tell me, Chief, what—how much money is left in that road fund? You got over $200 million.

Mr. ROBERTSON. In appropriated funds, there is $190 million.

Senator MELCHER. Left? How much is left in fiscal 1987 appropriation?

Mr. ROBERTSON. We would probably have around 60 to 75 percent of it left.

Senator MELCHER. You may have well over $100 million left?

Mr. ROBERTSON. It is what is planned, and we will have it spent by the end of the year.

Senator MELCHER. Oh, you think you will have it spent by the end of the year?

Mr. ROBERTSON. Yes, sir.

Senator MELCHER. Well, $200 million and some—was it $220 million?

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[1] See Appendix II.

Mr. ROBERTSON. Last year the appropriated funds was $229 million.

Senator MELCHER. $229 million and you are going to spend it all this year. And you tell me that there is a bridge in the Lima Peaks area in the national forest that nobody can find any money to repair? You know, that is almost unbelievable.

Mr. DUNLOP. Where was that again, Senator?

Senator MELCHER. Something is going on, that with the moneys appropriated a bridge cannot be repaired. I just ask you to look into it.

Mr. ROBERTSON. There are several bridges in this budget, I think about 75. But we will look at that situation.

Senator MELCHER. I thank you.

Now, on the logging, tell me where you are at in helicopter logging? Do you have any proposed sales for helicopter logging?

Mr. ROBERTSON. Yes, sir, a few, but much less than there were several years ago.

Senator MELCHER. I just talked to some people down in Darby that are working on a helicopter logging sale, and they seem to be coming out all right. I am glad to hear that. I encourage you to look into as many of those as you can, because the road budget—the road funding is the biggest headache we have here, as you well know.

And we face a lot of opposition, people saying: Well, you have got about 30,000, 40,000 miles of road stretched in there. I think it is even more than that in the National Forests now. Why do you want another new 3,000 miles?

Mr. ROBERTSON. I would like to point out, Senator Melcher, that we build roads not only for the immediate timber sales, but looking for the long term management of a piece of land. If we go in and spend our money for a helicopter sale, which is much, much more expensive than normal logging practices, that we end up not having the road for the next timber sale or for other uses.

Senator MELCHER. I understand that. But in many of these areas, the construction of the road is very expensive to begin with and causes a lot of problems and opposition to the Forest Service program.

Tell me, the one million dollars that is in the budget for fire fighting says that that does not mean anything, it is just going to come in for the supplemental. Was $125 million enough last year?

What did you finally end up spending in fire fighting?

Mr. ROBERTSON. We spent $115 million last year.

Senator MELCHER. 115?

Mr. ROBERTSON. Yes.

And you appropriated $125 million.

Senator MELCHER. Did you have $10 million left over to start with, or did you return that to the treasury?

Mr. ROBERTSON. We have $10 million left over. That is either returned or it will be used to offset fiscal year 1988—or 1987, rather.

Senator MELCHER. Why are we going back to just going on supplementals? Did Congress request you to do so or recommend it, or what?

Mr. ROBERTSON. The way we handled it this year has been traditionally the way we have handled it up until last year.

Senator MELCHER. Yes, I know.

Mr. ROBERTSON. In which Congress decided to appropriate in advance. The primary reason for that is we do not know, we never knew in advance how much money we need for fire fighting.

Senator MELCHER. When you get to a supplemental, you do not know either.

Mr. ROBERTSON. The supplemental is after the fact, and we know exactly how much we spent.

Senator MELCHER. Which supplemental are you talking about?

Mr. ROBERTSON. This would be if we had not appropriated money or you had not appropriated money for 1986, we would have had a supplemental this year for the fire fighting expenditures we had in 1986. So we would know exactly.

But just to give you the range, in 1982 we only spent $27 million for fire fighting. In 1985, which was one of our worst fire fighting years, we spent $167 million. So it ranges all the way from $27 million to $167 million. So you never know in advance how much you need, although I must admit the wisdom of the committee last year. $125 million came out very, very close.

Senator MELCHER. What supplemental are you talking about now? Are you going to request a supplemental this fiscal year or are you talking about a supplemental next fiscal year?

Mr. ROBERTSON. It would be a supplemental next fiscal year.

Senator MELCHER. So the savings in the budget proposal that you present, $125 million of that plus one million dollars, was simply on bookkeeping in what fiscal year it is paid in, whether we go back to having the procedure of having the supplemental.

Mr. ROBERTSON. Yes.

Senator MELCHER. You do not have much saving in there, in your budget proposal there.

Mr. ROBERTSON. We are probably going to spend about the same amount of money for fire fighting whether it is handled the way it was last year or——

Senator MELCHER. I understand that. But I say overall, you have not presented a budget that has much savings in it, except what is taken out of counties and States for not sharing the money under the usual procedure.

Mr. ROBERTSON. There are big areas where there are reductions. That is the payments to the counties, the State and private forestry funds that goes to the State land acquisition, and about $30 million less road construction.

Senator MELCHER. And $125 million less one million, $124 million—that is just bookkeeping—on fire fighting.

Mr. ROBERTSON. That is correct.

Senator MELCHER. Well, I am not going to berate you on that. I do not know how good a job you did last year. We got the ranking member of the Appropriations Committee, and I think he looks at it all the time.

Might I ask the Senator from Idaho, what is the preference of the Appropriations Committee in this matter?

Senator MCCLURE. Well, obviously we have the Chairman and the ranking member on this committee.

The CHAIRMAN. Senator McClure advises us on forestry matters.

Senator MCCLURE. I try to.

Senator MELCHER. Would you tell us what you preferred on this?

Senator MCCLURE. Last year, we added it in with the estimate for the first time and appropriated it up front, instead of going to a supplemental. We did that because we thought it was a more accurate portrayal of the budgetary impact of government operations and easier to calculate by putting it in up front than it was to wait and try to get budget waivers and go over the Gramm-Rudman-Hollings effort in a supplemental later.

We thought it would increase the pain up front and decrease the pain at the end.

Senator MELCHER. Well, it may be done the same way, it sounds like to me, this year.

Now, one last request, Chief. Would you inform me whether or not the fire fighting, that you have had a good review of—whether or not you keep on those fire fighters who are not permanent employees, only have temporary spots for perhaps up to ten years, whether or not they are given first option, whether or not they are given enough encouragement so they will stick around for fire fighting season?

Mr. ROBERTSON. Well, a lot of our experienced veteran fire fighters are people who work seasonally, because fire fighting is a seasonal job. And we do not have the funding nor the work to keep them busy year-round.

Senator MELCHER. I am interested that you keep that experience, and make sure you give them enough encouragement so they do stick around and sweat out the two or three months they are not working for the Forest Service and drawing a paycheck and never getting any of the advantages of fringe benefits as permanent employees.

And by the way, is that national hero named Anderson yet permanent? Would you check it out? We have been giving national awards to him for the last two years for saving the life of somebody who was on fire and risking his own life in doing so, and when I talked to him a year ago, although he worked for the Forest Service for eleven years as temporary, he had never been offered permanent.

It seems to me that the honor is great, but the family would be benefited if it were permanent.

Senator FORD. It sounds like the bank. They give you an increase in title, but no increase in salary.

Senator MELCHER. Yes. They give you a medal, it is nice to have it home, but it does not help the bank account.

I bring this up because I know last year there was a great deal of concern in region one that people who had been temporary were not given enough encouragement to stick around and be hired first, be told when they are going to be hired, and they were not available for fighting fires.

And so they were picking up inexperienced people, working into these crews, which is a dangerous practice. If you get very many of them in there, somebody is going to get killed because you are creating too many green fire fighters.

Mr. ROBERTSON. Yes. Many of our veteran fire fighters, as you point out, are temporary, seasonal employees, and if we were to lose them we would have a problem.

Senator MELCHER. Thank you very much.
Mr. ROBERTSON. I will check into Mr. Anderson's situation.
Senator MELCHER. Thank you, George. And thank you, Senator.
The CHAIRMAN. Senator Bingaman.
Senator BINGAMAN. Thank you, Mr. Chairman.
[The prepared statement of Senator Bingaman follows:]

STATEMENT OF HON. JEFF BINGAMAN, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

I thank the Chairman for holding this oversight hearing on the proposed fiscal year 1988 budget of the U.S. Forest Service. I want to make a few general observations about this budget request.

I continue to be concerned by this Administration's misplaced priorities when it comes to protecting our nation's forests. Once again this year, the Administration is giving emphasis to road construction activities at the expense of protective and preservation efforts. No money has been requested for new acquisition under the Land and Water Conservation Fund and the Agency is seeking a rescission of all of last year's appropriated funds. The highly successful State and Private Forestry Program is being cut 40 percent and all financial assistance to the state with the exception of the Cooperative Pest Action Program would be discontinued. Once again, the Agency is proposing to place most of its enforcement emphasis on drug interdiction efforts at the expense of other important areas.

I am particularly concerned by the Agency's lack of commitment to cultural resources protection and preservation. I will address this concern further in questions.

Mr. Chairman, I hope this Committee will make its concern over this budget clear to the Administration. We cannot support a budget that does not provide the necessary protection for our nation's most valuable assets.

Senator BINGAMAN. Let me ask Mr. Robertson, if I could, about the law enforcement activities that relate to cultural resources. This is something that was not covered in your earlier statement. We have got quite a few people in our State concerned that archaeological sites in the national forests are not being adequately protected or managed by the Forest Service, and that there is substantial damage being done to those sites.

Could you tell me what you could about the extent of the commitment you made there in the budget?

Mr. ROBERTSON. Yes. First of all, New Mexico's situation is that we did have a lawsuit there in New Mexico, and the charge was we were not fully complying with the National Historic Preservation Act and we needed to beef up our efforts to make sure that we did comply and were protecting the archaeological resources.

As a result of the settlement of that lawsuit, we have agreed to step up our survey and investigation of the archaeological values there, historical values, before proceeding with any kind of ground-disturbing activities, and with a significant amount of increased training for our people and, even though this is a very tight budget, because of the circumstances we are proposing a $2.1 million increase in cultural resource management for the Forest Service, and a significant amount of that would go to Arizona and New Mexico because of our situation there.

Senator BINGAMAN. Then you would expect that the settlement you entered into there and that lawsuit in New Mexico would result in improved Forest Service protection in other regions besides just region 3? Is that what I am understanding you to say?

Mr. ROBERTSON. Yes, we are looking at that on a regionwide basis. And the situation we have in Arizona and New Mexico is a very rich or abundant amount of archaeological artifacts and

values there, that complicates our management much more there than it does in some of our other regions.

Senator BINGAMAN. But do you expect that, with this increase of $2.1 million, you would have the resources necessary to properly carry out that Act and protect these sites?

Mr. ROBERTSON. Yes, I believe so. It is a good first step.

Senator BINGAMAN. These cultural resource management areas are designated. The concern, of course, is that once designated, really nothing is done to manage them in a proper manner.

Is it your view that systemwide throughout the Forest Service cultural resource management areas can be properly managed under the budget you have submitted to us?

Mr. ROBERTSON. Yes, I believe so. We can manage the areas. It just takes us being very careful and having some professionals in there that really know what they are doing, so that we design our activities in such a way that it does not damage or adversely impact these cultural resources.

Senator BINGAMAN. Okay. Let me ask, if I could, about the use of the forests—I think in the initial statement there is reference made to increased recreation fees and the anticipated additional revenues from that. How much do you expect to pick up through increased recreation fees this next year?

Mr. ROBERTSON. Well, currently we have about—collect about $30 million in recreation fees, and with this new legislation we think we can increase that by an additional $16 million. And there are some other areas that we are also looking at increasing the fees, which we believe will add up to about $52 million in 1988.

Senator BINGAMAN. What are those additional areas where you pick up fees?

Mr. ROBERTSON. Primarily summer homes on the national forests.

Senator BINGAMAN. Summer homes on the national forests?

Mr. ROBERTSON. Yes, sir.

Senator BINGAMAN. As I understand it, the Land and Water Conservation Fund Act provides now that you can collect fees at recreation facilities having basic amenities such as toilet facilities, drinking water, refuse containers, or tent or trailer spaces.

Why is that legislation not adequate to allow you to go ahead and collect the fees you need?

Mr. ROBERTSON. The reason for that is the national forests have a lot of relatively primitive campgrounds and picnic areas in developed recreation sites. We have about 6,000 in the total Forest Service, and only about 2,000, somewhere between 2,000 and 3,000 of those, meet these four criteria that is required by law.

So we would like to relax those criteria so that we could collect at additional recreation sites.

Senator BINGAMAN. So as I understand it, your proposal is to collect a fee for people going to a picnic area, even if it did not have a restroom facility or any kind of other facility there, is that correct?

Mr. ROBERTSON. What we would like is the option to collect fees at those kinds of sites, assuming that it was—we could collect it and it would not cost us more to collect than we would get out of it. So it would be some of those sites, depending on the local situation.

Senator BINGAMAN. And have you calculated the anticipated cost of doing this? I guess what you would have to do is have Forest Service personnel traveling through the forests looking for people who were having picnics and stopping and charging them; is that the way this would be done?

Mr. ROBERTSON. Well, we would—we need to do some creative thinking about how we would collect these fees. We do not anticipate a big force of people out there stopping people and collecting the fees. We would primarily go on the basis of people being honest and providing an opportunity for them to deposit their money.

We would kind of use the game warden approach. If we were out there for some other reason, we might check to see that everybody had the permit. And another option that we are looking at and is extremely successful is what we call our camp stamp program, where we sell people camp stamps and they can buy those in advance and then use them as they go out and camp or use the national forests.

Senator BINGAMAN. But it is my understanding that in order to go up into the forest and have a picnic, you would have to have a camp stamp or a permit; is that my understanding?

Mr. ROBERTSON. In those recreation areas that would be designated as fee areas, and not all of the 6,000 would be designated fee areas because we do not want to get into the business of trying to collect funds in an area where just the payoff is not there. It costs us more to collect it than we would collect.

Senator BINGAMAN. So the expectation is that the $16 million would be a net figure, the $16 million additional that would be collected as part of your budget receipts is a net figure?

Mr. ROBERTSON. No, that is a gross amount of increase in user fees, and it would probably take, I do not know, $2- to $4- to $5 million to collect that. But where we are proposing to collect, it is a net increase in receipts over cost, and it pays for our effort to do that.

Senator BINGAMAN. Could you provide the Committee—you do not need to right now—but could you provide us with a regional breakdown of your 1988 budget as it relates to the law enforcement efforts aimed at cultural resource management, so that we could see what is in Region 3, and what is in the other regions? That would be helpful.

Mr. ROBERTSON. Yes. I would be glad to do that.

[The information referred to follows:]

Information on the specific funding for law enforcement for cultural resources is not available. However, the following is a table of FY 1988 cultural resource management funding by Region, in thousands of dollars:

	Region									
	R-1	R-2	R-3	R-4	R-5	R-6	R-8	R-9	R-10	Total
Fiscal year 1988..	1,088	667	1,855	724	1,948	2,610	972	1,591	522	11,977

Senator BINGAMAN. Mr. Chairman, I have some other questions that I would like to submit for the record, if I could.

The CHAIRMAN. Yes.

Senator Ford.

Senator FORD. Thank you, Mr. Chairman.

The thread in this fabric of running the Federal Government continues, and that thread is we want to run it like a business. Well, I think the Senator from Idaho, Senator McClure, kind of came around on that fairly hard this morning, Mr. Secretary.

I think government should be run like a business, but not "as" a business. We do not budget as industry does. We do not take any assets and play that against liabilities. If we did, you could balance the budget before midnight tonight, if you would begin to take all the value of the buildings and land, but we do not budget that way. Therefore, we are not going to.

There is a trend here that I want to follow along with Senator McClure. We took revenue sharing away, and that was at 50 cents on a dollar, really, because there was no increase since 1972, and we now find one State where there are 120 counties and 40 of them about ready to go bankrupt. When those counties screw up their courage—and the county commissioners know they are not going to be re-elected for casting the vote—they put on a one percent payroll tax. The biggest objector is the Federal Government—the biggest objector is the Federal Government.

So when you take a local governmental entity that tries to make up for the loss that the Federal Government has cut, and they do that, the biggest objector becomes the entity of the Federal Government. Somewhere along the way you have to be consistent. If you want the locals to help themselves, then you cannot try to step on their neck any further.

It begins to bother me a great deal. We come in here beating our chests about Gramm-Rudman-Hollings, we have got to meet the Gramm-Rudman-Hollings, but you are getting ready to come back with a supplemental. So the figures you give us today are false. If you have some fires, then the figures you give us today are basically false. We have no iron-clad ability at the end to say we are going to be within the Gramm-Rudman-Hollings.

We come in here with a budget, the last six years, and it has never decreased. It is over a trillion dollars today. We increase defense—and I am not opposed to that. We increase foreign aid, and we say no new taxes. But the budget goes up. So what do you do? You come in here and cut counties. You come in here and cut communities. You come in here and cut States, and you cut them by 90 percent. Somewhere along the way we are going to have to put our income on the table, look at our needs, and try to come up with a budget from there.

So the thread here bothers me, and I think it bothers the Senator from Idaho also, particularly as we know it. Now we could change the percentage on the net. We could just give the States 50 percent of net instead of 25 percent of the gross. That would fix it and probably make it even, would it not? We could just change that percentage. It would not be any trouble at all.

So let me ask two quick questions, and then I will not get on with my sermonette. You ought to get the full load one of these days, George.

Chief, when you say you are going to rely on the States for fire fighters, what does that mean? If you reduced $125 million to $1

million, as Senator Melcher said, that is $124 million less than you had last year, and about $116 million of that you needed. So tell me how you rely on the States for fire fighters?

Mr. ROBERTSON. In our State and private forestry program, we have a fire protection item under that. Part of that goes to the States for joint training of their fire fighting crews, and they receive the same training that Forest Service fire fighting crews do.

We get into peak crisis situations—in fact, the last two years has been a very bad fire season, two of the worst in history. In 1985, we put about 20,000 fire fighters at one time on the line fighting major forest fires mainly in the West, but also the East had a serious problem. In 1986, at one time we had 17,000 fire fighters on the line, and about 8- or 9,000 of those I believe were State crews. So we have worked very closely with the State Foresters so that we have crews that are well trained, are physically fit, they are national crews which the Forest Service can use, as well as other agencies that have a crisis, to move those crews throughout the country to fight fires when we get into a crisis situation.

That then prevents each of the agencies from having to staff up to the peak situation in a crisis situation.

Senator FORD. How much do you have budgeted for State fire fighting training?

Mr. ROBERTSON. In fiscal year 1988, all we have is technical assistance where we will work with the States and help put on their training. We would not be paying for that as part of this budget.

Senator FORD. And that is training?

Mr. ROBERTSON. That is training.

Senator FORD. And that is what you rely on? Basically you are going back to the fact that this State will pay most of the cost for training those fire fighters.

Mr. ROBERTSON. We will use our technical assistance and our experts to come in and help work with the States to help train their crews.

Senator FORD. But that is very little cost compared to what the States are going to be out. It is just another item that you are laying off on the States to help the Federal Government. It is just one additional item. If you are just giving them technical assistance to tell them how to train, then somebody has to pay. That is just like sending in a substitute teacher. That bothers me a great deal.

Go ahead, Chief.

Mr. ROBERTSON. The States have to have their own fire fighting crews.

Senator FORD. Oh, I understand that. I understand that, but they pay for it.

Mr. ROBERTSON. Under this proposed budget, yes.

Senator FORD. But Kentucky would not have to have our fire fighters ready to go to Idaho. We would just take care of our own. If you did not have them, you would not have any.

Mr. ROBERTSON. Well, Kentucky needs to have their fire fighting crews well trained——

Senator FORD. For Kentucky.

Mr. ROBERTSON [continuing]. For Kentucky, but Kentucky does not have a fire going on all the time. So when Kentucky does not have a problem, then we can move them to Idaho.

Senator FORD. Well, are you in control of those? Or is it at the Governor's acquiescence? How do you get the fire fighters?

Mr. ROBERTSON. We have a cooperative agreement with all the State Foresters and the State Forester of Kentucky, whereas if Kentucky does not have a crisis fire situation and we have one somewhere else, then they are made available to the Forest Service.

Senator FORD. What I am saying is, Kentucky pays, or Idaho, or wherever, pays for their training of the State fire fighters and all you lend them is technical assistance.

Mr. ROBERTSON. In the 1988 budget, that is one of the changes from the 1987. In 1987 we did have funding going in to help train those crews.

Senator FORD. So that is just another cut, is it not, to the States? I want to make that point here, that we just begin to pick away, and pick away, and pick away.

Now let us talk about fees. You talk about $16 million increase is going to cost you $3- to $5 million. You are going to use a police State game warden to make people think they are looking over their shoulders. If you increase the fees, what is the increased attendance going to be? It is going to be decreased, is it not?

Mr. ROBERTSON. I would think it would be pretty much the same. There may be a few people that would not be willing to pay.

Senator FORD. So what we are doing, we are saying that we are raising the fees to a point to offset the budget deficit fees paid by those who that want to use the national parks and the national area. Therefore we are going to have less people able to come to our natural resources on our Federal lands, our Federal parks, because we are going to increase fees because we are trying to meet Gramm-Rudman-Hollings and not decreasing foreign aid, not decreasing defense, and we are not decreasing some other areas.

Mr. DUNLOP. Senator, if I might offer a point of view here, if I may?

Senator FORD. I wish you would, because your point up to now, George, has not helped me any.

Mr. DUNLOP. Yes, sir. The idea about these recreation user fees, this is a very modest proposal. We are not contemplating activity that would do anything other than help improve the quality of the services we have there. The funds would be designated for the account that goes to improving the recreational facilities.

We find that there is a great acceptance among the using public to be willing to pay a fee. We are talking about very modest, minor, light fees. The idea is that if we could get these funds and direct it, we could improve the quality and prevent the degradation. We could pave parking lots. We could pave boat ramps. We could put in toilet facilities. We could repair tables, and do things like this that up to this point we simply do not have the resources to do.

I would certainly want to bring to the attention of the Committee that the kind of recreation user fee activity we have in mind is very, very modest, not intrusive, and all of our surveys with the

people that come onto the Forest lands indicate that they would be willing, ready, and eager to do their part. They want to know where. Many people come and want to know where can we contribute.

We do believe that this recreation user fee approach is very, very modest. It will be the kind of thing that this Committee can keep oversight over, and we would earnestly request that we have access to these resources, these dollars to help us improve these facilities.

Senator FORD. Well, I am going to try to see that some of those resources go to some areas in my State that are being continually cut back. In any States employees are being cut back, your biologists, and so forth, are being cut back; the public is unable to go to some of the areas; roughly 3,000 jobs around the area depend on that, yet it is going down all the time; the job opportunities are going away.

So all we are doing up here is just seeing that edge get a little bit tighter, and pretty soon we are going to fall off the edge.

Two quick questions, Mr. Chairman, and I will be through. I have a lot more for you.

While the timber sales' level remains consistent in your budget with 1987 appropriation levels, there is a shift, as I read it, of volume between regions, particularly the Northwest. The sales level decreases about 400- to 500-million board feet. Can you explain the reason behind the shift, and the expected ramifications of such changes, and why the increase in the South?

Mr. ROBERTSON. In the Pacific Northwest, you are right. In 1987 it was 5.2 billion board feet; in 1988 we are proposing 4.8 billion board feet. The reason for that in the Northwest is that the timber sale program has been boosted in the Northwest in both 1986 and 1987 because of the tremendous amount of buy-back timber that we had in that region, plus a rapidly increasing harvest level in that region.

So we are back now at 4.8, which is about where we were. In fact, it is above where we were in 1985.

Now in the South, again markets are good; harvest levels are up; and we are proposing 1.45 billion board feet in 1988 as compared to 1.26 billion board feet in 1987. So it is a matter of markets, and demand, and trying to keep an adequate supply of timber under contract.

Senator FORD. Let me then get to one point, and then my last question. I may have some questions to submit to you in writing.

The Forest Service budget discontinues 90 percent of all financial assistance to the States, with the exception of the pest management area, I guess. Timber supply studies, notably the recently completed Southern study, show that we will become increasingly dependent on supply from nonindustrial private landholders, particularly in the South. These lands have been traditionally undermanaged and underutilized.

Could you explain how the discontinuation of assistance to the States will affect our ability to tap this supply?

Mr. DUNLOP. Yes, sir. Indeed, in fact the amount of assistance that the Federal Government has directed to State forestry programs has really served as a deterrent to the States coming up with imaginative and aggressive proposals for economic develop-

ment of these resources. They just figure, well, the problems that we face are kind of Federal problems, we will get Federal dollars and we will fight fires, and, you know, that is the way we will look at our jobs.

What we have been trying to do—and I think with some success—we have been going to State forestry directors, or commissioners of forestry, or chiefs of the State Forest Service, and we have been saying, you all have this immense, this tremendously valuable resources that, as you have indicated, is being terribly underutilized in your State. Can you not mobilize the forces in your State that are interested in economic growth and making this timber and other resources more valuable there?

We are finding that as State foresters look at their job as an expanded role, that they are getting aggressive and they are doing lots of things. We can cite Virginia. We can cite Michigan, Pennsylvania, and other places like that where they have been very, very innovative.

So this transfer of this concept that, hey, you guys out here have a lot of resources. You need to tend to them. You need to develop them. It is a responsibility that can indeed be met in a diverse economy and a diverse geographical and climatic situations like we have by State leadership.

Senator FORD. With those innovative ideas, would those funds go to schools and roads?

Mr. DUNLOP. Yes, sir. Any type of activity that creates economic growth will indeed generate income for counties and States.

Senator FORD. Oh, wait a minute. But there is nothing designated.

Mr. DUNLOP. No, sir. These types of activities will be primarily private sector activities, not even State government activities. Most of the lands that you have identified are in the hands of people that have 100 acres or less of trees. If we can begin to get the States to prioritize and focus and identify where these resources are and encourage their development—for instance, one study that has been done at one of the universities, at Duke University, have found that——

Senator FORD. Where is Duke located?

Mr. DUNLOP. It is in North Carolina.

Senator FORD. Thank you very much.

Mr. DUNLOP. That if a private landowner who has a wood lot would use the services of a professional forester, he can increase the net return on the timber harvest by 60 percent. And yet, we have evidence which indicates that very few landowners are using a consulting forester when they try to tap that resources. So most of this activity that we see taking place in the South's four forests that you have identified will indeed be a private-sector activity that is pretty much unrelated to the Federal Government.

Senator FORD. Mr. Chairman, I will let his remarks to my question, I will let history tell whether he was right or wrong, and I will yield the floor.

The CHAIRMAN. Thank you, very much.

Questions to be submitted for the record for the Forest Service should be in to Tom Williams or Beth Norcross in room 308 of the Dirksen Building by 5 p.m. today.

Now before I turn it over to Senator McClure for further questions, I would like to say two things.

First, I would advise that you send word back to OMB to thank them immensely for their advice on their new and innovative ideas about how to save money, but that the Committee was not enthusiastic about those ideas.

Senator FORD. "Less than enthusiastic. [Laughter]

Mr. DUNLOP. I will report that faithfully, Senator.

The CHAIRMAN. And secondly, I want to thank Chief Robertson and his Deputy, Chief Leonard, for enduring the baptism by fire before the Committee. You did an excellent job, and you as well, Assistant Secretary Dunlop. Of course it is not your first time, so it is nothing new to you, but we appreciate very much your being here.

Now for further questions, Senator McClure.

Senator MCCLURE [presiding]. Thank you very much, Mr. Chairman.

I, too, want to join in the suggestion that was made by more than one Member that indeed not all of these ideas originated with you, nor with the Forest Service, and if the questioning sometimes gets pointed and you are there, there is no place else we can point except through you to those people who may have come up with the ideas.

Does the Administration intend to submit legislation with respect to your recreation fee proposals?

Mr. DUNLOP. Yes, sir, indeed we do. It should be forthcoming in a couple of weeks.

Senator MCCLURE. Might I make one request, and make it rather urgently? Most of the restrictions and guidelines with respect to the recreation fee question are contained in the Land and Water Conservation Fund. The reason I mention that is, and perhaps I should not even say it publicly because I know from whence you came, but I should say it publicly so you will know from where I am coming, an amendment to the Land and Water Conservation Fund comes to this Committee which has written most of the legislation in this field.

If it is free-standing legislation, it may well be referred to the Agriculture Committee which has had no real association with this issue in the past. We have a jurisdictional question up here that can be best addressed by amending the fundamental statute which contains the current law, and I would request that you do that.

Before departing from that subject let me make just a very brief statement. I think Congress has always been sympathetic to the notion of fees which are levied for the use of facilities which have a particular locus, or location, or expense, but not for general entry. I think Senator Bingaman very properly pointed both to the difficulties and hinted at the reactions if we depart from that principle and attempt to get general entry fees. I do not think Congress would be very receptive to a general entry fee.

Mr. DUNLOP. No, sir. And in fact, not only would it not be something we would desire or want, but it is totally impractical the way the Forest Service is. There is no gate. There is no fence around the place. It is not like many of the Interior Department activities which are very highly regulated as to people's use.

Our philosophy is, and we feel very strongly about it, these national forests are to be properly and prudently used. We welcome people on the national forests. The more, the merrier. It is only in these types of areas where there are very high, intense concentrations of people, parking lots and things like that, that we would seek to use those fees.

Senator McCLURE. Mr. Secretary, I appreciate that statement. I think that helps us get some idea of what the Administration desires, and perhaps helps us as we deal with the question of the legislation when you submit it.

I want to follow for just a moment on the line of questioning that Senator Ford very properly and very wisely brought up with respect to the transfer of timber harvests from Federal to non-Federal lands. That is kind of nationwide in some respects.

As you look to private and non-Federal lands, that would be both individual and industrial and State lands that are involved, and look for increased harvests from those lands, you quite properly indicate what is a fact, that more intensive management of those commercial timberlands could yield more saw timber from those sources and relieve the burden on the Federal lands.

At the same time, there would be people who would point out that you are not really intensively managing the commercial lands on the Federal lands; that particularly under the new developing forest management plans, you are establishing annual sales quantities that have nothing to do with biological yield. The only relationship you can really say there is is some sort of low biological yield, and sometimes as much as four or five times low biological yield.

If we are going to ask State and local forestries—industrial forests and private forests to be more intensively managed—is it not also logical to suggest that the Forest Service and the BLM manage their public, commercial forest lands as intensively as we are expecting others to do?

Mr. DUNLOP. Yes, Senator, I think that is a very, very good point. I am going to ask George Leonard, who was the Director of the Timber Management Division of the Forest Service prior to his appointment as Associate Chief, to expound on that a little bit.

But let me say first that many of the questions that arise or issues that arise in terms of the further use and exploitation of the privately owned resources is almost a geographical division. In the Southeast right now, for instance, we have an immense recovery, an incredible recovery of forested woodlands in the Eastern part of the United States. This is a resource that is now mature. It is coming onstream. It needs management. It is privately owned.

Some of those questions that arise do not really apply to the management of timberlands that are privately owned in the Western part of the country where we do have mature stands of timber that are old growth, and are not just coming on but are indeed reaching the end stage of their existence.

I think that one can even turn the other side of the coin. The implication of your question leads to it. A lot of the industrial-owned and privately owned forests in the West where there is this mature old-growth timber are indeed very, very intensely managed, perhaps even too intensely managed. One of the things that we can

do in the Forest Service by more intensely managing our lands is provide some relief to those overly worked private lands.

So these questions vary in their scope and their intent and their entire perspective as one goes from East to West. But, George, perhaps you would have some thoughts that would be of particular interest to the Committee.

Mr. LEONARD. Well, Senator McClure, as you are aware, in our forest planning process one of the most difficult questions we have to deal with is expectations of demand as it applies to the National Forest. That addresses the question both of what is the total demand within the country going to be, and including opportunities for export of private timber, but also includes potential shifts from private either industry or non-industrial forest lands, to Federal lands, or shifts in the other directions.

This is an area where we are not perfect prognosticators. When we started this current round of forest planning five years ago, roughly—at least that is when we got into it most intensively—we were at the bottom of a period of extremely depressed markets, and people had varying expectations of what the world was going to look like over the next decade.

Certainly where we are today is much higher than most people were predicting in terms of demand for timber resource use. It is much higher today than we would have predicted five years ago. It requires that we go back now and relook at those things, and that is one of the things we tried to do in that study that you showed an interest in in the State of Idaho.

We are doing similar things on the other National Forests trying to perfect our estimates of what the demand for this resource is. Of course the same thing applies to the other resources of the National Forest, the levels of recreation demand, the levels of output that we should maintain for the fishery and wildlife resources. But we are particularly focusing on the levels of timber demand, because that is a much more fluid market and it is subject to much wider variation in demand because it is so closely tied to the general economy of the country.

But we are looking currently and actively in every one of the regions at, given what we know today, what is our best expectation of demand, and how can the National Forest respond to that?

Senator MCCLURE. Mr. Leonard, Mr. Secretary, I appreciate the comments that have been made, and I think that in many respects the philosophy which you are expressing is exactly right. I am somewhat concerned about some of the applications of that. I know you are, too.

For instance, I am sure you have read some of the studies I have that indicate that your estimates of non-Federal forestry in the Southeast may be 30 percent higher than realistic. If you are off by 30 percent and the private forestry yields 40 percent less than your estimate, then you run into a very real regional impact upon public lands.

In my State of Idaho in the Timber Supply Study, I think you would find that over the next decade it is expected that there will be a shift in or maintenance of the private land contribution to the saw-log base rather than any increased demand upon the public land. If that were in the forest management plan, there would be a

marked shift in the aggregate of the draft forest plans from the public lands to the non-Federal lands.

If that does not materialize, then the region will be short of saw-logs. If it does materialize according to the timber supply study, then the timber supply study indicates there will be an adequate supply of the non-Federal sources to meet the estimates of the Forest Service, but by 1994 there will have to be a marked upturn in the harvest from the Federal lands. That is what the supply study says.

Now the draft forest plans call for no upturn in 1994, and none in the next 15 years. So if the supply study is correct, the draft plans are low even on the face of it. Two Forest Service documents, one is a supply study and the other are the plans by which you are going to manage the forests differ. One says there is an adequate supply, and the other says you will create a shortage.

So we have to be somewhat concerned about which of the studies the Forest Service or the draft plans may be correct.

Secondly, I think it is fair to say, and I know we will have the opportunity to discuss this more in detail, that in very real terms in Idaho the projected harvest on private lands, as a matter of Forest Service policy, would almost call upon the non-Federal producers to cut out and get out, in effect. Now that is a buzz word, and it is a harsh term. To put it another way—and I use that term because that gets through the public consciousness of what is really involved—that if the private lands, and many times they are industrial lands, continue to be managed as they have in the last ten years, in less than ten years they will be completely out of saw timber.

And if they are completely out of saw timber, then the entire burden falls upon the public lands with dramatic—and I use that term—a dramatic upturn in harvest required, or a dramatic downturn in the forest industry.

Is it possible, Chief, that if the forest management plan calls for one level of harvest for the next 15 years, which is the planning cycle, and the inventory study that your agency has developed indicates that in 1994 there will be a dramatic increase in demand upon the public lands, how can you accommodate to that if the draft plans do not say so now?

Mr. ROBERTSON. Well, the planning process calls for us setting an allowable sale quantity level, which is the level that we would sell over the next 10 years. So we would either have to set the allowable sale quantity high enough to accommodate that, or amend the plan.

One of the things we are looking at is looking at some of these acres that are productive timberland, commercial timberland that is not brought in as part of our management to meet the projected demand or allowable sale quantity, and be able to consider bringing those into timber production through an amendment of the forest plan.

Senator MCCLURE. What does an amendment to the forest plan require in terms of just process?

Mr. ROBERTSON. Well, it would require an environmental analysis and public involvement.

Senator MCCLURE. It requires the full process that in essence is about the same process as the initial plan.

Mr. ROBERTSON. Well, I would not say—it depends on how much we deal with that in the original plan.

Senator MCCLURE. But assume that you do not deal with it in the original plan.

Mr. ROBERTSON. Yes.

Senator MCCLURE. You just march up to the end, and then you see the end and you attempt to amend the plan.

Mr. ROBERTSON. Well, there are amendments to the plan, and there are revisions to the plan. We would not envision this requiring a revision of the plan, which would be a complete redo, but it would have to go through the NEPA, National Environmental Policy Act, procedures and the public involvement.

Senator MCCLURE. And how long does that take?

Mr. ROBERTSON. It depends upon the controversy of the issue and the significance of the issue in terms of environmental impact, but probably a year at best.

Senator MCCLURE. Have you ever done one in a year?

Mr. ROBERTSON. Yes, we have several amendments——

Senator MCCLURE. Where it involves roadless areas?

Mr. ROBERTSON. I do not believe so, in roadless areas, but we do have several amendments to our plans in Colorado, and some of them are relatively minor, but we have made several amendments within a year—less than a year.

Senator MCCLURE. Let me get to a rather larger scope than just the Idaho question. Is the 11.1 billion board feet contained in the present budget the same as the agency's request for fiscal year 1988? If not, what program level did you request?

Mr. DUNLOP. While he is looking that information up, Senator, in response to your previous question, I do think that one of our most serious management problems that we have to attend to is to resolve the kinds of complications you have raised. We have really got to give clear direction in what these plans mean and do, and how they account for these economic considerations that you have.

We have devoted a lot of attention to try to make sure our terminology is correct, and that it does not lock us in one way or another if there are circumstances that change. For instance, we have had some discussions about the use of suitable, or the use of scheduled and nonscheduled in terms of our allowable sales.

We hope that by being able to work through some of these things and being more precise in our terminology, we can give a clear understanding that just because some area is not scheduled does not mean that it is not suitable for timber production.

Mr. ROBERTSON. Yes. The agency request was 11.1 billion board feet. The Department of Agriculture's request was 11.1 billion board feet. And OMB approved 11.1 billion board feet.

Senator MCCLURE. That was the level set in this year's appropriation bills?

Mr. ROBERTSON. 11.2 in 1987.

Senator MCCLURE. So you are going down by 100 million board feet.

Mr. ROBERTSON. Yes.

Senator McCLURE. For the past three years—that would be since 1984—consumer demand for lumber products in the United States have set new records, while the domestic lumber industry has only recently begun to see some recovery from the worst markets in history.

What projections in demand did you use in arriving at your sale program request? Are we going to have 1.8 million housing starts per year? Are you projecting 2 million, or 1.5 million?

Mr. ROBERTSON. We are projecting 1.9 million housing starts.

Senator McCLURE. So you are projecting increased housing starts over the current level?

Mr. ROBERTSON. Yes. I believe the 1986 housing starts was about 1.8.

Mr. DUNLOP. And of course we probably should point out that the actual sales in harvested timber will be 11.8.

Senator McCLURE. 11.8?

Mr. DUNLOP. Yes, sir, as compared with about 11.5 last year, or this year for 1987.

Senator McCLURE. And how do you accomplish an increased harvest?

Mr. DUNLOP. Senator, it mostly relates to the activities that come from the timber contract buy-out legislation. There was a lot of this timber that had previously been sold but is on the books and it simply has not been performed on. With that legislation now becoming operable, these contracts are now being performed.

Senator McCLURE. Well, the contract buy-out will be reoffered. That will be in your reoffer volume, not in your harvest volume. It is not reflected above the 11.1, it is reflected in the 11.1, is it not?

Mr. ROBERTSON. That is correct.

Senator McCLURE. So that to the extent there are contract buybacks that are reoffered, they do not increase the volume. The only place you can get increased volume above your sales quantity is in the backlog of contracts that are in the performance category, not in the buy-back program.

Mr. DUNLOP. Yes, sir. That is correct. I misspoke.

Mr. ROBERTSON. Mr. Chairman, as of October 1, 1986, we had 26 billion board feet of timber under contract.

Senator McCLURE. And you have about 2.7 billion of remaining volume under the buy-back, I believe.

Mr. ROBERTSON. That is what is in the 1988 budget.

Senator McCLURE. Is that not the total quantity, not just that which is in the 1988 budget?

Mr. ROBERTSON. I believe there would be about a billion board feet left in comparison to what we bought back. Some of those sales probably will not be resold. So there are a few sales that would spill over in 1989, but not very much.

Senator McCLURE. All right.

Now there has been a recent action taken with respect to Canadian lumber imports. The Canadian Government agreed, after a series of negotiations and a tremendous amount of pressure and an awful lot of complaint on their part, in responding to complaints on this side of the border, they agreed to levy a 15 percent export tax on that lumber.

Is that going to affect the volume of Canadian timber that enters the U.S. markets?

Mr. LEONARD. Maybe I could respond to that, Senator McClure. You can get about as many opinions as you can line economists up on that issue. There is a fair body of expertise which believes that it will not have a significant impact on the actual volumes, although it will have an increase on price generally across the U.S.

On the other hand, some well-qualified economists do think that certainly over the long run it will have an impact on the level of Canadian participation in our market, and particularly when we get into the downside of the market. But given the record demands that we have today, I suspect that all the mills, both U.S. and Canadian, will be going pretty much flat out for the next year.

Senator MCCLURE. Well, that might indicate that in indeed if we had wanted to reduce the volumes, we should have enacted a quota legislation rather than depend upon tariffs.

Mr. LEONARD. At least that is what some of the economists would suggest.

Senator MCCLURE. And I think the Administration was opposed to any kind of a quota. Is that correct?

Mr. DUNLOP. Yes, sir, that is correct. A lot of those Canadian mills are state of the art, and they are going to be able to——

Senator MCCLURE. They certainly are. And what are they selling their saw logs for, the stumps, compared to U.S. stumpage costs?

Mr. DUNLOP. George?

Mr. LEONARD. Well, a very small fraction of ours.

Senator MCCLURE. A very small fraction.

If consumer demand remains high, what will be the effect on those consumers if the sales program remains constrained to 11.1 billion board feet?

Mr. LEONARD. Historically we have tried to maintain a sales program which maintains a reasonable level of volume of timber under contract. This means that we sell a little bit more than we harvest in the down part of the market, and we build volume under contract with the ability to pull it off and reduce the volumes under contracts during the peak periods.

The question of course comes: Given the volume of timber that was bought back, the volume of high-priced sales that remain under contract and which can only come back into the market as a small share in each time, and the fact that we are moving in to about the fourth or fifth year of a continuing recovery, whether or not the peak may stay up at a level long enough where we will reduce the volume under contract to a point where it will begin to constrain a firm's ability to operate?

Mr. DUNLOP. And of course our long-range planning under the RPA—while I do not have that document immediately in front of me and I cannot recall those numbers specifically—they do call for significant increases in the outyears into the 1990s and the 21st Century.

Senator MCCLURE. First of all, I think it is obvious that if the demand is greater than supply, price will rise. Therefore, the consumer impact. Consumers should expect to pay a little bit more for their lumber under the scenario that we are seeing presented to us. Is that not correct?

Mr. DUNLOP. That scenario that we are now operating under. Of course we had some earlier discussion this morning about the South's four forests and these more intense managements of existing resources. It remains to be seen, at least in my mind, as to whether we are going to see significant prices.

The economists tell me, Senator, we are going to see rising real prices for wood fiber as far as we can see.

Senator MCCLURE. Right. So that is the scenario that we expect to happen and consumers should expect that result, both from this and from other causes.

Mr. DUNLOP. We are going to watch it real close, though, I will guarantee you.

Senator MCCLURE. Well, I am sure, and you will get lots of help from lots of people in watching it real close. I do not question that you will.

I believe it is kind of a rule-of-thumb in the industry that there are about three years' supply under contract at any one time. I think now we are about 2.5?

Mr. LEONARD. That is a long-term rule of thumb. I would point out that that was developed during a time when the cost of stumpage was a relatively small fraction of the total operating cost. Today, stumpage, particularly in the Pacific Northwest, is a significant portion of operating cost.

So some firms are beginning to develop different strategies and, just as clear costs are in the general industrial area, we have learned how to manage inventories at lower levels. So there are probably more firms moving down below that three-year average.

Nevertheless, it is clear that a firm, if he is going to get adequate financing, if he is going to carry out his road construction in a purposeful way, must have adequate volumes of timber under contract.

Senator MCCLURE. And if we are at annual harvest level of 11.8, that would indicate we should have under contract about 35 billion board feet under contract, and we are substantially below that.

So if I look at it, we are not only below historic averages under contract, we are below harvest levels in sales offerings. So that we are increasing the gap between harvest and volume under contract. Is that not correct?

Mr. LEONARD. That is correct; yes, sir.

Senator MCCLURE. That is a matter of policy as stated by your budget.

Mr. DUNLOP. Well, it is a budget constraint, yes, sir.

Senator MCCLURE. It is a budget constraint, even though this is a program that makes money.

Mr. DUNLOP. Well, it would make money if we—I will not pursue that. [Laughter.]

Senator MCCLURE. Well, let us put it out there on the table. If it makes money, are you not better off in a budgetary sense to have more volumes moving through contract, and getting that volume up, and getting the money into the Treasury?

Mr. DUNLOP. Senator, I think that we can demonstrate that. We have done a lot of analysis. We can demonstrate, we believe, that we can get a return in the same year. For a long time there was an assumption that, well, that money comes in a couple of years from now. But I think we can demonstrate that if we can have a timber

sale program, we can return the amount of money that it takes to make that investment that fiscal year.

Senator McCLURE. I agree with you, and I think you can demonstrate it, and I think it has been demonstrated, and I think you need to state it publicly. But it also means that keeping the sales program down is adverse to the budget.

Mr. DUNLOP. I think so, in many, many ways. Now you get these other complications we have discussed this morning in there into that calculation.

Senator McCLURE. Your recommending a timber sale program of 11.1 billion board feet does not include a response to the upswing in demand over prior years. I think that is a correct statement.

Mr. LEONARD. I think so. Mr. Chairman, I would like to comment on what we are talking about, the profit or the cost and receipts of the timber sale program. Our calculations are that this 1988 timber sale program of 11.1 billion board feet will bring in receipts of $802 million. Our expenditures for producing this timber sale program are estimated at $480 million. That will show a profit of $322 million, or 67 percent on investment. I would put my personal money on the National Forest Timber Sale Program and invest it.

Senator McCLURE. I wish I could. I agree with what you say, and I think it is an important fact. If your sales program were above 11.1 billion board feet, you would have an even larger increase in the profit you make for the Treasury.

Mr. DUNLOP. And that does not even include, Senator, the amount of taxes that would accrue to the government and to the economy generally through meeting the needs of an expanding and growing economy.

Senator McCLURE. And it does not include the increased recreational opportunity——

Mr. DUNLOP. Wildlife enhancement, and all the rest.

Senator McCLURE [continuing]. And a number of other things that come along with the sale of the program, which I think we all agree upon.

Let me ask this question, then. If indeed the harvest of timber of the public lands is above the sales program, could the sales program level be increased without exceeding growth rates from the suitable-acres base recommended draft and final forest plans?

Mr. ROBERTSON. I think we would have to answer that question on a forest-by-forest basis and look at it.

Senator McCLURE. In other words, can we increase the sales program and still operate on a sustained-yield basis?

Mr. ROBERTSON. In some areas, particularly like Oregon and Washington, we are right up at the sustained yield level.

Senator McCLURE. And in Idaho?

Mr. ROBERTSON. In Idaho, we are below the sustained yield level based on the old plans.

Senator McCLURE. I think just for the record it might be well to note that the Canadian share of our market has increased by 15 percent in just the last few years. If this 15 percent tax up there has any effect, it ought to enable our producers in this country to recapture some of the market lost to Canadian producers, recognizing that a 15 percent tariff is kind of median. Many of us had sug-

gested it would take about 30 percent to offset the difference in their cost of production and their cost of marketing.

So I do not know how significant the increase in market share for domestic producers will be, but there ought to be some change—although certainly it is hard to know whether the Canadians will find other markets, and what they will do to respond to increased costs marked by that 15 percent tax.

Mr. LEONARD. Senator McClure, I think one thing it is safe to observe is that it is almost certain that there will be a pass-through of costs, or rather an increase in the value of the stumpage nationally. Certainly the issue of below-cost sales has been one which has been a concern, and it has been a concern to the Congress.

I would anticipate that the difference in values of stumpage, the pass-through of the stumpage, will make a shift and take many of our forests who have been marginally in deficit and put them on the plus side of the ledger now.

Senator MCCLURE. I think that is probably true. One of the problems we had over the last decade was the very, very high-priced sales, particularly in Region 6, that led to the buyout program that was very controversial. There were a lot of reasons why that happened, I suppose, but one of which was timber operators who were running their margins lower and lower under contract with increased demand and decreased supply were involved in what some would call desperation bidding.

Are we not running the risk of creating the same kind of condition again if we have our harvest levels above our sales levels with a projected increased demand in domestic market and a decreased supply from Canada? Are we not setting the stage for another round of desperation bidding?

Mr. LEONARD. Certainly there is going to be an incentive for people to try to acquire volumes of timber from a limited base, and the way to do that is to bid the price up.

Senator MCCLURE. Are we not really creating an apparent scarcity?

Mr. LEONARD. If you look at bid rates today at average bid rates throughout the country, I do not see the evidence that we are getting desperation bidding at this time.

Senator MCCLURE. Not yet.

Mr. LEONARD. But we are certainly getting individual sales that get run up to higher levels than we feel comfortable about.

Senator MCCLURE. If we want to create stability or maintain stability in the industry, if we want to maintain stability in the housing industry without bidding prices up, is it not a good public policy to make an adequate supply available? Mr. Secretary?

Mr. DUNLOP. I would say absolutely, Senator, we have to be very conscious about that.

Senator MCCLURE. Where is the greater danger on offering more for sale, or less for sale? If you err on the high side, what are the consequences as compared to erring on the low side of timber supply?

Mr. DUNLOP. Well, of course the way we have to operate in the public policy forum, there are all kinds of negatives for offering more timber than one could argue there is demand for, because many people would have us not use any of these timber resources.

Senator MCCLURE. I understand.

Mr. DUNLOP. So there is an enormous expenditure of political capital that people who favor prudent use of the forests have to deal with. I think that needs to be played out first.

In terms of the economics, obviously there is an equilibrium that is best attained and best identified in a market economy like we have through price. If we begin to see that the timber costs are adversely affecting economic performance, I think that is a real signal to the economists, to this committee, to the Administration that we are not supplying adequate amounts of timber to the economy.

Senator MCCLURE. All right, you are then going to try to fine-tune that on an annual basis. There is not much you can do to change it in less time than that, is there?

Mr. DUNLOP. I think that is right, Senator. I would hope to think that none of us would perceive ourselves as having the responsibility for fine-tuning timber prices. I hope that we are not at a situation where the government ought to be doing that kind of thing, but, yes, we have to monitor that thing very, very closely.

Senator MCCLURE. All right. Let me use a different term than fine-tuning, then, if you do not like that term, and I am conscious of the fact that that in effect becomes a buzz word in some respects.

You are going to try to adjust timber supply on an annual basis as you measure its effects upon the market and the variations in the economy.

Mr. DUNLOP. Well, Senator, I think that is a major consideration, but in terms of a policy that I can address—now I may stand further corrected by the gentlemen who give this Administration counsel, because we follow it very closely because we respect their professional judgment—but fundamentally I believe we come to this in the Administration with a conviction that we have an obligation to supply a growing economy the resources it needs.

Senator MCCLURE. But you will do that on an annual basis. That is what I am getting at.

Mr. DUNLOP. Yes.

Senator MCCLURE. It is not something you make a decision on in 1987 that will remain in effect for 10 or 15 years?

Mr. DUNLOP. That is absolutely correct. Now we do have the RPA where we try to give the Congress and the public an idea of where we see this headed in a long-range planning way.

Senator MCCLURE. You are anticipating where I am going. And I agree with you. But if you are going to adjust these volumes according to the demand in the marketplace, and you are going to make those estimates yearly, then you may increase or decrease offerings on an annual basis.

Now if your Forest plan sets a ceiling at today's basis, how are you going to increase the amount that is offered in 1988 or 1989?

Mr. DUNLOP. Well, in my regard I would hope that the Forest plans do not establish that kind of rigid ceiling.

Senator MCCLURE. I agree with that hope. So far, it has not been met by reality.

Mr. DUNLOP. Well, maybe I can ask the Chief to bail me out here a little bit.

Senator McCLURE. Well, the Chief has the capacity to bail you out. The question is: Will he? [Laughter.]

Mr. ROBERTSON. Mr. Chairman, we have talked about the land management planning process before and some of the problems with that, with the allowable sale quantity being really an upper limit, but I would like to point out that is an upper limit based on the life of the plan, ten years.

Senator McCLURE. Right.

Mr. ROBERTSON. So we can go up and down in any one year to reflect market conditions as long as the ten years we balance out.

Senator McCLURE. If the first part of that period is above your projections, then you have a greater crisis in the latter part of the period unless the demand goes below your projections.

Mr. ROBERTSON. That is correct. And then the other conversation we had is, we always have the opportunity to look at the situation and amend the plans if the situation changes.

Senator McCLURE. Well, let us take a hypothetical. Let us take some forest with 150 million board feet ASQ. Can you in the first year of that plan offer 180?

Mr. ROBERTSON. Yes, sir.

Senator McCLURE. And how will you make that determination?

Mr. ROBERTSON. We would look at the market conditions and the needs, as well as our budget situation, and we could make that decision.

Now what we make when we make that decision in year 4, 5, 8, or 10, or somewhere out in the future, we would have to make up for that.

Senator McCLURE. You would have to make up for it by amending the plan, unless the market goes below it.

Mr. ROBERTSON. Yes. And the timber market does go up and down.

Senator McCLURE. It goes up and down, but as I look at the draft forest plans for Idaho, it is based on the down and not on the up. As it fluctuates, you could take a median——

Mr. ROBERTSON. Yes.

Senator McCLURE [continuing]. And if you take the median, you can go above or below that. But if you set your ASQ at the bottom of the market, then how do you go up? I am reminded of what somebody said: Government policy can take the peaks and valleys out of economic swings. They said that to the farmers. The farmers noted the first thing that happened is they took the peak off. Right? What happens then when you get to the valleys? If you start at the bottom and you have not taken the peak off, you are only guaranteeing that you have the low. You have no opportunity to recover to a median or to the high. That is what the draft plans in Idaho are doing.

For some reason, the methodology and the constraints that were ordered by the Washington office has translated downward to the regional offices, and from there to the forest supervisors and has put in certain constraints and has resulted in a harvest level program projected at the bottom level of the market with no opportunity for the recovery of the market, and no opportunity to make the adjustments for the swings.

If you start at the bottom of the market, there is no place to go. That is what I think has happened out there. For some reason in some way—I know you are familiar with my concerns—Secretary Meyers asked that an economic impact study be made. When we got the economic impact study, it was only a timber supply study. There were a couple of paragraphs in the several pages in that study that dealt with economics. All the rest of it dealt with timber supply.

But even those rather cursory economic evaluations said there would be 683 jobs lost in Idaho as a result of the preferred alternatives in the draft plans. We are struggling to maintain our economy. It is not because of a lack of timber; it is because of the judgment that was made, or whatever constraints were passed on down to the forest supervisors and the regional foresters that ended up with that result with no flexibility.

According to the timber supply study, the preferred alternatives would, unless met by increased cuts from outside from the non-Federal lands, would result in some $27 million a year in receipt loss, and some $245,000 a year reduction in the amount of the 25 percent fund going to the counties.

Now there is something out of sync here, if I regard it correctly, and I think it starts with the 11.1 billion board foot level. Do we have some gnome down in OMB that does not agree with you that selling timber makes money?

Mr. ROBERTSON. Yes, sir.

Mr. DUNLOP. No, sir. They——

Senator MCCLURE. The answer was "yes, sir," Chief?

Mr. DUNLOP. Oh, it was?

Mr. ROBERTSON. We have had some discussions on that.

Senator MCCLURE. I thought I heard you say "yes, sir," and I wanted to make sure the reporter got that. [Laughter.]

Mr. ROBERTSON. We have had a lot of discussions on the economics of our timber sales. I think we want to lay it out just the way it is. As I mentioned before, our overall timber sale makes money. There are some national forests that are marginal, or even below cost, and there have been discussions on that.

Senator MCCLURE. Some individual sales are. As I recall the draft plans in Idaho, the timber supply analysis in Idaho would indicate about 7.8 billion board feet moving to market from Idaho forests over the next 10 years. But the roads built to harvest that 7.8 billion board feet would also move another 5 or 6 billion board feet in the next decade.

Mr. DUNLOP. As well as to supply measurable amounts of recreation and other wildlife enhancement, other things like that.

Senator MCCLURE. So when we look at deficit sales, we will be looking at that 7.8 billion board feet against the cost of those roads, even though it is only about half the total timber that we move over those roads.

Mr. ROBERTSON. Yes. And I think in managing the National Forest we have got to keep the long-term perspective. We are not in business just for this year, or this decade. We are trying to look out in the long term how these forests ought to be managed, and they take some up-front investments in order to meet the various outputs and the needs from the National Forest.

Senator McCLURE. Well, I agree with that statement. One of the hardest things to get done in the ups and downs of budget cycles is to get stable, long-term management of natural resources. I think every value in the natural resources suffers from that. We need stable management to be able to enhance fisheries. We need stable management to protect water quality. We need stable management for the wildlife values that are there, and for the recreational values.

I think that is one of the greatest challenges we have is to be able to go through the fluctuations of political opinion and market economics toward stable management of the resource.

Mr. DUNLOP. Senator, I think——

Senator McCLURE. Mr. Secretary.

Mr. DUNLOP [continuing]. That in this line of thinking that we would certainly be willing to work with you and the Committee to look at each of these plans in a detailed way, if you wish, the ones you wish to look at in a detailed way, because we share the same types of concerns you are expressing.

Senator McCLURE. Well, Secretary Myers apparently saw what I had seen independently, because I watched the draft plans coming out forest by forest in Idaho and I can see ASQ levels progressively going lower and constraining the level of the timber industry in Idaho, and I began to wonder what there was in the process that was compelling that result, particularly when there is available saw timber there that could be made available for increased harvest levels.

Secretary Myers saw the same thing happening from a different perspective and ordered that the economic impact be analyzed, and I think his recognition was the same as mine. There is something happening in the process that does not yield the goals we say we are for.

Mr. LEONARD. Senator McClure, if I might interject there, as I indicated earlier we are relooking at—based on the Idaho study and where markets are today—we are looking at the current demand and where it is likely to go, and recognizing that looking backwards at what has happened over the last five years, or the last ten years is not a good reflection and not a good basis for making judgments of where we ought to be for the upcoming decade.

It needs to be recognized, and I am sure you do, however, that there are competing demands out there for those resources.

Senator McCLURE. Sure. An awful lot of competing demands.

Mr. LEONARD. That is correct. And demand projections are only one of the factors that are influencing where the people are coming out on their preferred alternatives.

Senator McCLURE. You identified the harvest levels at 11.8 billion board feet per year. Of that volume, how much of it is saw logs, and how much of it is other than saw logs?

Mr. LEONARD. I would estimate that in excess of 90 percent is saw logs.

Senator McCLURE. In excess of 90 percent? That means about a little over 1.1 billion board feet would be something other than saw logs.

Mr. LEONARD. Yes.

Senator McCLURE. Is that true also of the 11.1 billion board feet harvest level that is set in the budget?

Mr. LEONARD. Yes, sir.

Senator McCLURE. So that the actual harvest of saw logs is under 10 billion board feet.

Mr. LEONARD. Yes.

Senator McCLURE. Now I think it is sometimes stated in the budget that this meets the demand created by housing and other construction markets. Actually, there is at least some portion of this harvest that has nothing to do with construction.

Mr. LEONARD. That is correct. The timber sale budget covers the costs of everything from pulpwood sales, post and pole sales, and firewood sales, a wide variety of products that we merchandise off the forests.

Senator McCLURE. Chief, how do we know that if you have to adjust the plan during the period of the plan to increase the harvest, that that can be accomplished by amendment and not by revision?

Mr. ROBERTSON. Well, I do not think we know for sure.

Senator McCLURE. And if we do not know for sure and somebody challenges it and says it must be a revision instead of an amendment, you have got another lawsuit?

Mr. ROBERTSON. That is very possible. That is a judgment on our part when we make the change in the plan. Is it significant enough to change some of the basic premises underlying the old plan that calls for a revision?

Senator McCLURE. Let me ask this question. Do you anticipate that if a change in the plan were required that increased roading in roadless areas, do you get by with less than a revision?

Mr. ROBERTSON. I think it depends on how good of a stage we set in the original plan for that, and how much——

Senator McCLURE. Are you assuming that all groups that are opposed to your entering a roadless area are always logical and always yield to your superior wisdom and your setting the stage for them? Or do they use lawsuits to accomplish their objective, which is to keep you out of the roadless area?

Mr. ROBERTSON. Well, the answer is, there are a lot of people who do not abide by my judgment and that they frequently resort to the courts or appeals when they disagree.

Senator McCLURE. And all they need is a filing fee and a mimeograph machine to file an appeal.

Mr. ROBERTSON. And a postage stamp.

Senator McCLURE. And a postage stamp. And there is always one person out there that is willing to do that.

Mr. ROBERTSON. Well, we——

Senator McCLURE. This is not by majority vote, is it?

Mr. ROBERTSON. No, it is based on an individual right to appeal a decision made by the Forest Service.

Senator McCLURE. So if they wish to appeal, it is very easy for them to do that.

Mr. ROBERTSON. Yes, it is.

Senator McCLURE. To go to the court with it.

Mr. ROBERTSON. Well, it is very easy to go through an administrative appeal; but to go to court is a little more involved.

Senator MCCLURE. It is a little more involved, but you still have got standard pleadings, have you not?

Mr. ROBERTSON. Yes.

Senator MCCLURE. Are you a lawyer?

Mr. ROBERTSON. No, sir. I am a forester.

Senator MCCLURE. You see, I have to ask that question to get it on the record. But you do know lawyers have form books, and that is all you have to have in order to file a lawsuit.

Mr. ROBERTSON. Yes, and there are a lot of——

Senator MCCLURE. They may not keep you there for very long, but it will get you there.

Mr. ROBERTSON. There are a lot of word processors at work, too, throughout the country.

Senator MCCLURE. That is right. So you punch the button, you mail the results along with the filing fee, and whatever postage stamp it takes, and you have got the Forest Service held up with respect to an amendment to the plan that you propose to do if somebody says, no, it should be a revision. Is that not correct?

Mr. ROBERTSON. Well it is our judgment, unless through the appeals process or the courts somebody overturns that judgment.

Senator MCCLURE. Yes.

Mr. ROBERTSON. And we also have the option of whether we issue a stay or not administratively. And those are individual decisions made on a case-by-case basis.

Mr. LEONARD. I might interject right there that on the final plans that we have issued, and there about 60 of those now, we have well over 400 appeals. However, all those plans are in place and we are administering the forests according to those plans while we are going ahead with the appeals process. So an appeal does not automatically stop the process, although certainly the courts have generally been fairly free with injunctions when the allegation is a NEPA failure.

Senator MCCLURE. Particularly where a NEPA failure is alleged, or particularly where irreversible change is alleged.

Mr. LEONARD. That is correct.

Senator MCCLURE. And entering a roadless area is almost both, by definition, is it not?

Mr. LEONARD. Yes, sir.

Senator MCCLURE. So if you have a high proportion of the decision that will affect existing roadless areas, you would have a high expectation that many of those would be challenged in the courts.

Mr. ROBERTSON. Yes. We are finding the entering of roadless areas throughout the country, even in States where we have wilderness bills with release language, extremely controversial.

Senator MCCLURE. The Idaho Timber Supply Study acknowledges in several sections that the use of historic median harvest levels is, and I quote, "intended to serve as baselines or points of reference, not as an indication of future timber demand."

Would the Forest Service please provide their current estimates for the timber demand in north and south Idaho?

Mr. ROBERTSON. We will provide whatever we have on that, Mr. Chairman.

[The information referred to follows:]

The Forest Service does not currently have recent demand estimates for Idaho. Regions 1 and 2 are developing demand estimates based on RPA and other supply/demand work underway in the Region. These estimates will be used in conjunction with the Idaho Timber Supply Study in developing final forest plans. This information will be provided to the Committee when available.

Senator MCCLURE. Would you also provide a summary of current mill capacity for the market areas in north Idaho?

Mr. ROBERTSON. Yes, we will.

[The information referred to follows:]

Chuck Keegan, University of Montana, Bureau of Business and Economic Research, estimates that the current mill capacity for North Idaho is 1.45 billion board feet, based on 1985 data. It should be kept in mind, however, the historic utilization of gross mill capacity ranges from 75 to 95 percent.

Senator MCCLURE. Previously published Forest Service data, particularly Idaho State and Private Forest Resource by Van Hooser and Green, has concluded that private nonindustrial harvest cannot be maintained due to inventory depletion beyond the early 1990s. In fact, one study, North Idaho's Private Woodpile by Alan Green, concludes that "the last big tree on private land in Clearwater County will be cut in about 1993." Yet, the report projects in north Idaho that inventory levels for private nonindustrial ownerships decrease slightly in the base scenario.

Could you explain the apparent discrepancy in those two statements?

Mr. ROBERTSON. I cannot, but I would like for Associate Chief Leonard to answer that, if he has the answer.

Mr. LEONARD. I cannot explain it, but we will try to reconcile those.

Senator MCCLURE. If you would, please, for the record.

[The information referred to follows:]

The information in "Idaho's State and Private Forest Resource" by Van Hooser and Green, and "North Idaho's Private Woodpile" by Green were based solely upon the net annual growth and annual removal of sawtimber on nonindustrial private lands collected for the year 1981. The "Report on Idaho's Timber Supply" takes the same data collected in the year 1981 and updates this information to the year 1985. Then, using TRAS (a timber volume projection model) projections of harvest volumes, growth, and inventory are made into the future. This is a much better procedure upon which to make statements about future inventories on nonindustrial private lands. Basically, the difference can be explained in terms of the amount of standing old growth volumes in 1981 (the inventory year) and relationship between increased growth on future stands as old growth stands are harvested. In other words, future net annual growth in total for nonindustrial private lands increases, and will exceed the sawtimber harvests predicted in the future.

Senator MCCLURE. As you might guess, I have several other questions which I will submit in writing for the record. Perhaps that is the best way to handle it at this time, with one final question for the record at this time.

The GAO and the Forest Service are very near to agreement on a timber sale accounting system, as I understand it. Will the agreed-to system affect the number of forests that move from nonprofitable to profitable?

Mr. ROBERTSON. I believe it will, because we are looking at investments in reforestation, timber stand improvement, and roads, and will be depreciating those off over a long period of time, such as a rotation rather than an annual expense for the year in which

it occurred. That will change the economics bottom line considerably.

Senator MCCLURE. Would you also supply this for the record, if you cannot answer directly. The roadbuilding costs projected in Idaho are about $35,000 per mile for new construction, and about $13,000 per mile for rehab reconstruction?

Mr. ROBERTSON. I would have to supply that for the record.

[The information referred to follows:]

The roadbuilding costs cited are average costs of construction and reconstruction on Idaho National Forests. They do not include costs of engineering and transportation system management. The total costs of road construction and reconstruction by Forest are being assembled and will be available later.

Senator MCCLURE. If you would, please. I do that because a number of conservation organizations had a press conference in the last two weeks in Moscow, Idaho, in which they charged again that the Forest Service was on a road-building binge, and that the costs would greatly exceed the benefits, and there was a public statement that the estimated costs of road construction was at $50,000 per mile, which they applied to the total number of miles to be built, rehab'd and reconstructed to get their public statement of the costs of the program.

Chief, is the Forest Service on a road-building binge?

Mr. ROBERTSON. No, sir.

Senator MCCLURE. I perhaps should have said, why are you?

Mr. ROBERTSON. We are not on a road-building binge. If you look at our number of roads we have built over the last ten years, we are on a downward trend.

Senator MCCLURE. What proportion of the roads are you building that are new construction?

Mr. ROBERTSON. About 40 percent.

Senator MCCLURE. And the rest is?

Mr. ROBERTSON. Reconstruction.

Senator MCCLURE. Reconstruction. Where do you charge, in your budget, the costs of the maintenance of a road?

Mr. ROBERTSON. That is in line item under "National Forest Systems."

Senator MCCLURE. Is that charged to timber harvest?

Mr. ROBERTSON. No, it is not. Now appropriated funds finances about 50 percent of the road maintenance cost. We charge commercial users and timber purchasers to pay for their own road maintenance. So the timber purchases are, I believe the exact percent is about 48 percent of the road maintenance comes from charging the timber purchasers as part of the timber sales.

So the funding and road maintenance in National Forests is to just cover the custodial type maintenance, plus taking care of the public users out there and Forest Service use.

Senator MCCLURE. Who pays for maintaining the road along Kelly Creek?

Mr. ROBERTSON. I suspect the Forest Service does, but I would have to check.

Senator MCCLURE. It comes out of the appropriated funds.

Mr. ROBERTSON. Unless there is a timber haul. I mean, a road will vary over time. In other words, there may not be any timber coming out for three or four years, which we would pick up all the

maintenance costs; and then if a timber sale is made, then the timber purchaser would contribute toward the maintenance of that road.

Senator MCCLURE. And appropriately. If there is no timber moving over it during a fiscal year and no maintenance charges to a timber operator, the cost of maintenance should not be then charged to timber harvest. That is correct?

Mr. ROBERTSON. That is correct.

Mr. LEONARD. Yes. The maintenance money that we get appropriated from the Congress to a major extent goes to accommodate recreation use on the National Forest.

Senator MCCLURE. And I mentioned Kelly Creek because it is a premiere fishing stream, and about the only people who use it anymore are fishermen and Congressional parties going in to look at it. I should not say that, because Congressional parties go in by helicopter. [Laughter.]

Senator MCCLURE. Finally, let me commend you on one statement you made that I think is a good trend, although I am not certain it can be universally applied; that is, land acquisition. You have indicated that there are zero funds requested in 1988 for land acquisitions.

Mr. DUNLOP. Well, three or four million dollars to close out our activities.

Senator MCCLURE. To close out existing activities, and further land acquisition shall be done by exchange.

Mr. DUNLOP. Yes, sir.

Senator MCCLURE. Now I assume that there may be occasions in which the landowner is not an operator in the usual sense of a timber operator, and he may not want any land in exchange. Will you make an accommodation for that in future budgets?

Mr. DUNLOP. Senator, there is a very little amount of money made available for that type of thing for these very, very high priority tracts of land. Also, we do have certain line items where we are under specific appropriated direction such as I think around Lake Tahoe and places like that where indeed we will do those things.

But as a general practice, it is very, very difficult for us to justify to indiscriminately expand the Federal estate. We were so pleased at the success we have had with exchanges—for instance, some statistics are interesting here. In 1986, 133,300 acres of land were acquired in exchange for 101,614 acres of National Forest System lands. All of this, in an administrative sense, cost us $5.2 million.

So we end up with a little bit more land, but we have exchanged less desirable parcels for those that are more desirable at relatively small cost.

Now on the other hand, we do have a very, very serious problem we believe with the interest of a lot of the special interest groups and other people to have the Forest Service acquire land for cash. We have got a real problem with that. In that same year, 1986, the Forest Service purchased 44,445 acres, about a third of what we got through exchange, for $31 million, as compared to the $5.2 million.

So the bottom line is that we can acquire three times more land by exchange than by purchase at one-fifth the cost. I really would like to engage the Members of this Committee, and indeed especial-

ly the Appropriations Committee, into some consideration about establishing some criteria in those instances where Congress is going to take a very, very personal and intense interest in specific acquisition tracts.

Senator MCCLURE. Well, I certainly applaud you for the direction you are headed. I do not disagree at all with the desirability of making exchanges where those are possible, and apparently under your leadership you are making some real headway there.

One of the difficulties you have of course is getting appraisals on two pieces of land so we are exchanging value for value. I do not think anybody wants to see an exchange that beggars the taxpayer and enriches someone else. That is a very difficult thing to do, to get the appraisals made and exchange parcels that are of equal value. Sometimes there has to be a cash adjustment, and usually that cash adjustment is required by the Federal Government.

It is very seldom that the private landowner in an exchange will pay some extra money, but it is not impossible. Are you open to that kind of a transaction where you have *x* number of acres on one side, and *x* number of acres on the other side, and $200,000 difference in value?

Mr. DUNLOP. Senator, I think when we are talking about these, I hate to use "$200,000" as a relatively "minor" sum, but believe me some of these tracts we purchase we pay $25,000 an acre for large tracts. These acquisitions run to the millions.

So yes, indeed, I think as a practical matter we would work with people. But if I may ask the indulgence of the Committee, I would like, even in those instances, for the Members to consider some additional criteria, keeping in mind that exchange for other land is our first and highest priority. A great deal of authority exists for the Forest Supervisor to exercise that on his own without any further approval from the Washington office.

However, in those instances where exchanges are not practical, we are trying to emphasize that acquisition of additional lands for cash in a budget deficit environment has got to be our lowest priority. If we could factor in some criteria that are not now being considered into those things, we would be very, very encouraged.

I have identified in some discussions with Members four or five items. First of all, exchange, having the highest priority. Donation of land would be a second priority, which is not outside the interest of the landowner. He gets certain tax advantages and other advantages for donating either entire tracts or parts of tracts.

Senator MCCLURE. Or scenic easements.

Mr. DUNLOP. Yes, sir. A third one would be scenic easements, what we would call a partial interest. Those are harder to manage, but nevertheless could achieve many of our objectives.

We also think that acquisition of land at less than fair market value is an option that the Congress really should look at. Oftentimes if you go out and assess or evaluate a piece of property per acre, indeed it could command a high value. But sometimes we buy these tracts in 4-, 5-, 8-, 10-, 20,000 increments, and we feel like maybe the Congress ought to appropriate a little less money when we are buying wholesale. We ought not have to buy every acre we buy retail.

Now we are required under law to pay the fair market value for land, but we could certainly entertain an offer for less. We think that the Congress ought to really be discriminating in that regard and would ask for cooperation.

Senator MCCLURE. I do not disagree with that point. I do not mean to interrupt, but are you not bound and are we not bound by the appraisal process?

Mr. DUNLOP. Yes, sir.

Senator MCCLURE. Are not the appraisers furnished or hired in most instances by the Forest Service?

Mr. DUNLOP. Come again?

Senator MCCLURE. The appraisers are either furnished or hired by the Forest Service?

Mr. DUNLOP. Well, not always. Not when the Congress is directing some of these acquisitions. We have the Congress, the Appropriations Committee, appropriating *x* number of dollars for a tract of land——

Senator MCCLURE. You mean specific line items?

Mr. DUNLOP. Well, yes, sir. It is in the Appropriations process.

Senator MCCLURE. Well, I remember one time a few years ago when the Forest Service had the opportunity to buy scenic easements on what later became the Hell's Canyon National Recreation Area. The property owner was willing to settle. The Forest Service refused to because their appraisal was low. Quite legitimately they refused to pay more than the appraised value.

It went to the court, and the court awarded, I have forgotten what it was, about ten times the appraisal. Now neither you nor I could have totally foreseen that result, but we could have yielded a little bit and made money even though—even though—it appeared to be above the appraisal.

I have crossing my desk, any number of requests for waiver of the rule in order to pay more than the appraised price. I think in every instance save one I have agreed. I have agreed because there was a judgment made that the appraisal was less than the likely recovery in court.

Now it starts then with the problem with the appraisal, which I think needs to be very realistic. Certainly we do not want to give the taxpayers' money away, but we may cost ourselves money by trying to be a little bit too close to the mark.

Mr. DUNLOP. Senator, I think we are really talking about two different types of acquisitions. I would think that you are exactly correct in those acquisitions that are mandated by law or by the court. In other words, when we are in some function of the taking, when we acquire somebody's property when maybe they would prefer that we not, or when we are under some other kind of——

Senator MCCLURE. Or they are trying very hard to get the best price they can get.

Mr. DUNLOP. Well, yes, but——

Senator MCCLURE. You know, there are some people who own property who, if the government is going to buy it, do not want to donate.

Mr. DUNLOP. Yes. And we are in a deficit environment, and we really need the cooperation of the Committee to help us establish

some criteria upon which the Congress would agree would be reasonable.

Senator McCLURE. I agree, and we will miss sometimes.

Mr. DUNLOP. Yes.

Senator McCLURE. Now has the direction been given to the Chief of the Forest Service? Have the local supervisors engaged in exchanges to exercise the authority that they have?

Mr. DUNLOP. Yes, sir, that is correct.

Senator McCLURE. And have you directed the regional foresters, and have they directed the supervisors to do that?

Mr. ROBERTSON. We have directed the regional foresters, and I am sure they have also directed the Forest supervisors.

Senator McCLURE. And if the Forest supervisor does not make an exchange when he might have, what is the hazard to his performance rating, as contrasted to the fact that he does exercise that authority when somebody says, hey, you gave away too much? Or you gave away the wrong tract of land? What is the hazard to his performance rating? As contrasted to the fact that he does exercise that authority, and somebody says, hey, you gave away too much, or you gave away the wrong tract of land. What is the hazard to his performance rating?

Mr. ROBERTSON. It can be a factor in his performance rating either way.

Senator McCLURE. Well, is it not more likely to be a negative factor in his performance rating if he does something that turns out to be criticized than if he does not do something?

Mr. ROBERTSON. Not from my perspective. I am encouraging our Forest supervisors to be very innovative and creative in figuring out how to get the job done.

Senator McCLURE. I wish you luck, because I think the guys at the bottom end of that structure—and you have been there—you know that making no mistakes is a lot less hazardous than making a judgment.

Mr. ROBERTSON. Well, I just recently sent a message to all Forest Service employees that loosened that up considerably.

Senator McCLURE. Well, I would anticipate they might make a mistake once in awhile.

Mr. ROBERTSON. And that is okay.

Senator McCLURE. That is okay?

Mr. ROBERTSON. Yes. As long as it is one that does not kill you.

Senator McCLURE. Well, as long as it does not kill them. That is what they are worried about. [Laughter.]

Senator McCLURE. And I sympathize with them, because generally speaking their errors are reflected much more than their not doing something.

Mr. DUNLOP. Well, you know, Senator, in that regard not only as it relates to land acquisition and managing the National Forest System, but indeed the other aspects of the Forest Service, the research and the State and private forestry activities, in particular the new Chief, Dale Robertson, has taken real leadership in trying to encourage and define those instruments of policy that would allow people to take risks and be innovative and be rewarded for good management.

In fact, one of these activities is what we call our "test" or our "pilot project" where we are encouraging regional foresters and Forest supervisors to use a great deal of innovation and judgment in the use of the funds that they have available to them, and to remove a lot of the overburdensome paperwork so that they have time to devote to more activities.

Then if they achieve real savings in the operation of their businesses of their activities, that they can apply those things to meet the Forest management plan at their discretion with their judgment. This type of attitudinal change, this idea that we are not going to sit up here in Washington and super-regulate your day to day activities as a Forest supervisor, but rather turn you loose to be creative and innovative and to produce in accordance with the law and the plan is something that has really I believe energized the Forest Service.

And the morale in the career ranks of the U.S. Forest Service I believe it is safe to say is as high as it has ever been, if not higher, because of the attitude that Dale Robertson and his predecessor, Max Peterson, had in this regard of looking at what you do in a positive vein rather than going around criticizing what one does for making mistakes.

Senator McCLURE. Mr. Secretary, I thank you for your testimony and you, Chief, and Mr. Leonard. I very much appreciate your testimony this morning. There will be some further questions to be submitted in writing for a response to the record.

Thank you very much.

Mr. DUNLOP. Thank you, Mr. Chairman.

Senator McCLURE. The hearing is adjourned.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

APPENDIXES

APPENDIX I

Responses to Additional Committee Questions From the Federal Energy Regulatory Commission

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D C 20426

CHAIRMAN

FEB 2 4 1987

Dear Mr. Chairman:

I am enclosing my responses to questions for the record associated with the Senate Energy and Natural Resources Committee's February 17 hearing on the Federal Energy Regulatory Commission's FY 1988 budget request.

I appreciated the opportunity to appear before your committee and am looking forward to working with you in the future.

Please let me know if you need additional information or if I can be of further assistance.

Sincerely,

Martha O. Hesse

Enclosure

Honorable J. Bennett Johnston
Chairman, Committee on Energy
and Natural Resources
United States Senate
Washington, D.C. 20510

QUESTIONS FROM THE MAJORITY

QUESTIONS FOR THE RECORD FROM
SENATOR J. BENNETT JOHNSTON

Commission Authority on Take-or-Pay Liability

Question 1: The Committee is aware that various parties have questioned the basis of the Commission's legal authority to deal with take-or-pay costs, and have questioned how the proposed policy for dealing with take-or-pay costs will be implemented. Please provide the Committee with a memorandum of law detailing the basis of the Commission's authority to take whatever steps will be taken, and detailing how the policy will be implemented.

Answer 1: In regard to your request for a memorandum of law detailing the basis of the Commission's authority to adopt and implement a policy statement on take-or-pay, buy-out, and buy-down costs, the Commission is currently considering such a policy statement but has not yet made a final determination as to its content. At such time as the Commission completes its consideration of the policy statement, the Commission's Office of General Counsel will submit to you a memorandum of law detailing the Commission's authority to issue such a policy statement and how the policy will be implemented.

Auction Pricing under Section 210 of PURPA

Question 2: Recently, several states, notably Massachusetts, have been experimenting with the setting of prices under section 210 of PURPA on the basis of an auction system. It seems to me that this approach lets ratepayers share directly in the economic benefits resulting from PURPA. Has the Commission considered mandating an auction system? Could it do so under the rulemaking powers it has under PURPA?

Answer 2: The Commission thus far has not formally considered altering its current regulations to mandate an auction system. On January 10, 1987, however, the Commission issued a Notice of Public Conference which requested public comment on an array of PURPA issues, including whether the Commission should reconsider its

current avoided cost rule and what alternative approaches for the pricing of power from cogeneration and small power production facilities should be considered. The Commission therefore will be reviewing possible pricing alternatives in the near future. Section 210 appears to give the Commission flexibility, subject to the § 210(b) prohibition that the QF purchase rate not exceed avoided cost, to adopt a pricing rule predicated on an auction approach.

Joint Boards

Question 3: A recent resolution of the National Association of Regulatory Utility Commissioners called for greater use of joint Federal/state boards in deciding matters of common concern. What is the Commission's position on joint boards? Section 209 of the Federal Power Act, which concerns joint boards, seems confusing. Does it need to be clarified?

Answer 3: Section 209 provides a means by which Federal and state regulators can confer either formally or informally on issues of mutual concern. It gives the Commission needed flexibility to determine when the use of a formal joint board would be appropriate, and not interfere with the rights of parties in ongoing Commission proceedings.

The Commission as a whole does not have a formal position on the use of joint boards. However, I would point out that in many instances joint boards would be a cumbersome and inefficient mechanism for resolving issues which could be resolved more expeditiously by other means. For example, the Commission recently held a joint meeting with the gas and electric committees of the National Association of Regulatory Utility Commissions to discuss matters of mutual concern. I think all participants found this to be a useful forum to discuss common problems and seek consistent solutions. We plan to hold another joint meeting in May.

If Federal and state regulators desire a mutual approach to mutual problems, the opportunities are there. I intend to foster these opportunities for this Commission to work together with state commissioners.

Prudence Review Practices

Question 4: Complaints have occasionally been made that the Commission does not do an adequate job of scrutinizing the prudency of investments under its wholesale ratemaking authority. Would you provide for the record a summary of the Commission's prudence review practices?

Answer 4: Under the FERC's ratemaking practices, costs sought to be collected in rates by utilities are initially presumed to be prudently incurred. However, the litigation staff analyzes whether prudence of particular costs may not be supported, and should therefore be an issue in the ensuing hearing. Among the factors which are looked at, if appropriate, are the need for capacity, planning of the generation unit involved, and least-cost energy strategies. If a prima facie showing of imprudence is made by any rate-case participant, including staff, the burden of proof shifts to the utility to demonstrate the reasonableness of the costs which it has incurred. At present, the Commission considers any finding of imprudence in a state commission proceeding to be a prima facie showing of imprudence.

The prudence standards adopted by the FERC require a utility to act reasonably in light of the facts and circumstances available at the time decisions are made. Management decisions are not evaluated from hindsight and are not necessarily required to result in fortunate outcomes. But, a utility must show that it sought out and made use of pertinent information at the time of its decisionmaking, and that it employed sound, generally acceptable decisionmaking techniques.

If a utility fails to prove that a challenged cost was prudently incurred, the responsibility for bearing that cost is shifted from ratepayers to the utility's stockholders. That is, ratepayers are relieved of all responsibility for costs judged to have been imprudently incurred.

QUESTIONS FOR THE RECORD FROM
SENATOR DALE BUMPERS

Prudence Reviews

Question 5a: Chairman Hesse, allocating the risks of capital investment between utility stockholders and ratepayers is an ongoing challenge for state and federal regulators of electric utilities. One of the methods used by regulators is the so-called "prudence review" which examines the investment decisions made by the utility to ascertain whether those decisions were prudent at the time they were made.

FERC has been criticized by myself and others for not devoting the time and effort it should to conducting adequate prudence reviews and for rarely, if ever, finding that a utility acted imprudently.

It has seemed to me to be particularly important that FERC conduct prudence reviews in those situations where some of the affected state regulators were denied the opportunity to do so. Otherwise there is really no forum in which ratepayers in the excluded states can be protected from imprudent utility management decisions.

How much of the Commission's budget is allocated to prudence reviews for FY 88?

Answer 5a: Although there are no funds specifically allocated to prudence reviews in the Commission budget for FY 1988, extensive efforts are expended in the area of prudence reviews (see Answer 5b). Prudence reviews are conducted during the course of electric rate cases involving a number of issues, including the appropriate rate of return and the allocation of costs to jurisdictional customers. State regulators may participate, as intervenors, in electric rate cases that affect ratepayers in their states and may challenge the prudence of any cost incurred by the utility.

There are about 17 dockets pending before the Commission involving 11 nuclear generating stations where allegations of utility imprudence have been raised. The Commission's effective jurisdictional shares of these units' capacity ranges anywhere from 0.1% to 15%.

Question 5b: How many staff members are assigned to this area?

Answer 5b: No staff members are assigned solely to conducting prudence reviews. There are about 50 personnel assigned to work as technical and financial analysts and 20 trial attorneys assigned to process electric rate cases. Approximately 35 additional technical and legal personnel act in an advisory capacity to the Commission, in writing opinions based upon initial decisions made by administrative law judges, briefs on exceptions to such initial decisions, and a review of the hearing record. Thus far the majority of prudence issues raised in electric rate cases have been settled by the parties.

Question 5c: How many have experience in conducting prudence reviews?

Answer 5c: Of the approximately 105 analysts and attorneys engaged in electric rate proceedings, about 40 of them have been involved in proceedings involving prudence questions regarding least-cost strategies or termination decisions to varying degrees.

FERC Position on Prudence Reviews

Question 6a: Your budget justification document states on page 5 --" Regarding prudence reviews, the Commission must address the question of whether after-the-fact prudence reviews fail the test as a good regulatory tool. Because these reviews occur after decisions to build a plant are made they divert important time and money away from finding ways to improve future efficiency."

How much of FERC's time and money has been diverted by prudence reviews?

Answer 6a: Although no funds are specifically allocated to prudence reviews in Commission budgets, there are about 17 dockets pending before the Commission where allegations of utility imprudence have been raised requiring commitment of Commission staff and time.

Question 6b: What do you mean by "finding ways to improve future efficiency"?

Answer 6b: The result of after-the-fact prudence review is to charge either stockholders or ratepayers for imprudent costs which have already been incurred. Additionally, the costs of the prudence review itself must be borne by some element of the public. A more enlightened and far less costly approach would be to find a way to prevent the imprudent costs in the first place. One step in this direction occurred on May 16, 1983, when the FERC issued its final rule permitting electric utilities to include up to 50% of their CWIP (construction work in progress) in rate base. The FERC stated that the rule would afford "an opportunity to review and judge the prudence of costs as those costs are incurred and claimed in rate base, rather than at a later point in time when a project is completed or abandoned and a potentially unwise investment has already been made." For utilities seeking CWIP in rate base, the rule requires the submission of "an explanation of why the program adopted is prudent and consistent with a least-cost energy supply program."

Other ways to improve efficiency are to enhance workable competition, through such measures as pricing flexibility, and incentives for improved performance. One way to create incentives is to provide "targets" which utilities must meet in order to obtain a certain level of revenues. For example, on February 9, 1987, the FEPC issued an order in Ocean States Power, Docket No. ER87-23-000, which accepted a power supply arrangement containing innovative provisions designed to encourage the efficient construction and operation of a generation unit. These provisions include:

1) a construction cost ceiling of $625/kw (adjusted for inflation); 2) penalties if the unit fails to achieve 90-95% of its design rating; and 3) an incentive payment whenever the unit exceeds a certain availability level with a corresponding penalty whenever that level is not met. In summary, these are some of the ways we hope to improve the future efficiency of electric power supply.

Question 6c: Whatever that phrase means, don't you think that a utility facing a tough prudence review at the end of a construction process thinks about ways to "improve future efficiency"?

Answer 6c: A utility facing the prospect of a "tough" prudence review would seek to ensure itself that any future investments it makes would pass muster. However, fear of after-the-fact cost disapproval by regulators may lead to the avoidance of capital-intensive investments, even if such investments may result, in the long run, in a least-cost energy supply program. A prudence review can be a powerful regulatory tool, but we are seeking a superior alternative which would allow review of utility costs much earlier in the construction process so as to eliminate costly after-the-fact investigations.

Substitute for Prudence Reviews

Question 7a: Your budget book also states that the Commission will be looking for a possible substitute for prudence reviews in the context of its Notice of Inquiry (NOI) on electric rate regulation. Can you give me an example of a possible substitute?

Answer 7a: An example of a possible alternative to prudence reviews may be the encouragement of unit sale contracts similar to one filed by Ocean State Power and discussed in Answer 6b.

Question 7b: Are you considering adopting a stronger test such as a used and useful standard or a cost benefit test for new capacity?

Answer 7b: The used and useful standard generally is applied in determining whether a utility should be allowed a rate of return on prudently incurred investment. It is not generally applied in determining whether to allow a return of costs for new capacity. The issue of whether to continue to apply the used and useful test in determining whether to allow a return on investment is currently pending before the Commission. (See Answer 9 re NEPCO proceeding.) The Commission is not at this time actively considering whether to apply a used and useful or cost benefit test in allowing a return of costs of new capacity.

Question 7c: Does the FERC have the authority to impose least-cost planning requirements on its jurisdictional utilities?

Answer 7c: The Federal Power Act confers upon the Commission's broad discretionary powers to establish just and reasonable rates. It does not seem likely that any utility would rationalize its particular long-term power supply objectives in terms other than least-cost, given the constraints that its situation presents. FERC Order No. 298, which deals with CWIP in rate base, requires that a utility make a threshold showing that it is following a least-cost strategy in its power supply planning.

In establishing just and reasonable rates, the Commission may disallow costs which it considers to be imprudently incurred. Therefore, through the ratemaking process, the Commission has the authority, in effect, to impose least-cost planning requirements on its jurisdictional utilities.

Question 7d: Have you received any comments from the public on this aspect of the NOI? Can you summarize these for the committee?

Answer 7d: The Commission received numerous comments on its NOI. These comments are being reviewed. Some of the comments on the subject of prudence reviews can be summarized as follows:

1. The standards by which utility decisions will be judged should be clearly set forth in advance of the decisions to be made.

2. Standards should be fairly applied through the adoption of similar penalty/reward limits.

3. Implementation of the standards should recognize the extent of management control (i.e. rewards and penalties should not be applied for results which are beyond management's control).

4. Responsibility for making planning and operating decisions should continue to rest with utility management.

5. Recognition should be given to a utility's obligation to provide service. There is a significant difference between the relationship of a utility and its customers versus the relationship between other business entities (which can determine the profitable level of demand to be served) and their customers.

Status of NOI on Electric Utility Ratemaking

Question 8a: What is the status of the FERC Notice of Inquiry on Electric Utility Ratemaking?

Answer 8a: I still consider follow-up on the NOI to be one of my top priorities. The NOI issues raised a number of fundamental questions about how the Commission should regulate bulk power and transmission service. I presented my first thoughts on some of these issues in a speech that I gave at the NARUC convention in November. These are complex and interrelated issues. It would be premature for me to talk about specific actions until I can discuss these questions at length with my colleagues.

Question 8b: Can you describe briefly what major issues are encompassed in the Notice of Inquiry?

Answer 8b: The NOI requested comments generally on the following issues:

- Pricing Flexibility In Competitive Wholesale Markets;
- Time Differentiated Rates;
- Transmission Access;
- Transmission Pricing;
- Timing Of Capital Cost Recovery; and
- Accountability For Investment And Operating Decisions.

Status of the NEPCO Proceeding on Abandoned Plants

Question 9: In response to Committee questions submitted after your confirmation hearing, you indicated that the Commission was "reexamining the appropriateness of its cancelled plant policy" in the NOI on electric ratemaking, as well as in an ongoing New England Power Co. (NEPCO) rate proceeding.

Can you bring us up to date on the NEPCO proceeding? Have you had an opportunity to review the Commission's cancelled plant policy or to reach any conclusions about it?

Answer 9: On February 17, 1987, the presiding administrative law judge issued an initial decision in Phase II of the New England

Power Company proceeding, Docket Nos. ER85-646 and ER85-647. Phase II was limited to a prospective resolution of the cancelled plant issue in New England Power Company's rate filing, in which it requested that the Commission reexamine its existing policy regarding the treatment of the costs of cancelled plant.

The Commission's order setting Phase II for hearing, 32 FERC ¶ 61,453 (1985), directed the presiding judge to resolve factual disputes, reserving policy questions for consideration by the Commission. Thus, the initial decision issued February 17 only makes findings of fact.

Because of the importance of this issue, the Commission sought to develop the fullest possible record, and therefore afforded the opportunity for other interested persons to participate in Phase II. As a result, fifteen parties participated in the hearing with testimony submitted by twenty-seven witnesses. Those participants now have an opportunity to brief the Commission on their exceptions to the initial decision, followed by an opportunity to respond to exceptions. Under § 385.711 (18 C.F.R. § 385.711 (1986)) of the Commission's regulations, that process is scheduled to be completed in April. The Commission will then analyze the findings of the initial decision and the briefs of the participants and render an opinion on all issues, factual as well as policy.

The process of developing an opinion in this case will offer the Commission an opportunity to review the existing cancelled plant policy and draw conclusions as to whether that policy, which allows a return of investment in cancelled projects but does not allow a return <u>on</u> that investment, should be retained or in some way modified.

QUESTIONS FOR THE RECORD FROM
SENATOR HOWARD M. METZENBAUM

Local Distribution Company (LDC) Bypass

Question 10: With respect to local distribution company (LDC) bypass, does the FERC see the need to prevent "cream skimming" of the LDC's most lucrative customers at the expense of the LDC's small volume commercial and residential customers? If not, why not?

Answer 10: Bypass can only occur after a proceeding before the FERC under NGA Section 7 wherein all interested parties may participate or after the affected LDC and State PUC are notified under NGPA Section 311. Thus, the Commission has considered each bypass case on its individual merits. As the Commission has long held, see Panhandle Eastern Pipe Line Co., 36 FPC 1107 (1966) and Missouri Edison Co. 47 FPC 849 (1972), the preference for service by an LDC is conditional and does not apply if economic considerations preclude it. Some states, such as West Virginia, have or are considering laws requiring state PUC approval for bypass while others, such as Pennsylvania and Ohio, have found utility-to-utility competition to be in the public interest. Recent cases before this Commission have entailed careful weighing of competitive interests in those particular cases.

In ANR Pipeline Co. and Techstaff Transmission Co., Docket Nos. CP84-386-000 and CP86-394-000, respectively, "cream skimming" allegations were made by the LDC, Northern Indiana Public Service Company (NIPSCO), and the case was set for formal hearing (34 FERC ¶ 61,236). Prior to the hearing, the parties reached a settlement, whereby NIPSCO agreed to transport 100 percent of the gas requirements for Bethlehem Steel's Burns Harbor, Indiana plant. At the outset of the case, NIPSCO refused to transport gas for Bethlehem,

but as time went on, agreed to increasing percentages of transportation. The state commission concurred with the settlement. The case is being held in abeyance pending certain state PUC approvals.

By order issued December 23, 1987, in Docket No. CP86-263-000, American Distribution Company (Alabama Div.) was authorized to transport self-help gas for Kerr-McGee, an industrial end user. The Commission approved the transportation over the LDC's (Mobile Gas Service Corp's.) objection in the circumstances where Mobile Gas' own sales contract with Kerr McGee had expired, and it had refused to transport gas from other sources (37 FERC ¶ 61,282). The state commission also opposed the proposal. Some volumes from local production were already replacing sales previously made by Mobile. FERC felt that the customer's access to competitive sources justified the proposal especially in view of the LDC's refusal to transport.

By order issued December 6, 1984, Panhandle Eastern Pipeline Company was authorized in Docket No. CP84-393-000 to transport gas for Hayes-Albion Corporation, an end user previously served with transportation of gas through Southeastern Michigan Gas Company. The transportation contract with Southeastern Michigan had expired several years before the proposal, and a little-used standby sales agreement had replaced it. Southeastern Michigan would have lost the business in any event. Moreover, it was demonstrated that Panhandle could render the service more economically than Southeastern Michigan.

Question 11: What has the FERC done to ensure that residential and small commercial customers benefit from, and are not disadvantaged by, the Commission's bypass policies?

Answer 11: As noted above, the Commission has ensured that bypass cannot occur without a proceeding under NGA section 7 affording all interested parties the opportunity to participate or notification of the LDC and state PUC under NGPA section 311. In addition, the Commission has given LDCs the opportunity to obtain services to take advantage of the increased competition in the industry. Such services may take the form of CD conversion, transportation by the existing pipeline supplier, standby sales service with transportation, incremental interruptible transportation, or even new sales or transportation services by competing pipelines. For example, in Docket No. CP84-533000, 30 FERC ¶ 61,288, Transco was allowed to transport gas on behalf of Baltimore Gas & Electric over Columbia Gas' objections. Similarly, Midwestern was authorized to add a delivery point to Peoples Gas (Ill.) over Natural's opposition (Docket No. CP86-206-000, 36 FERC ¶ 61,341). In another case, Texas Gas was authorized to increase sales to Cincinnati Gas & Electric Co. over Columbia Gas' (the existing supplier's) opposition (37 FERC ¶ 61,038). The benefits of competition were cited, especially in the latter two cases.

Question 12: Please provide any data the FERC has regarding how LDCs have used authorities available under Order 436 to reduce their contract demand and lower prices for their consumers.

Answer 12: Under certain of the settlements approved by the Commission to implement Order No. 436, customers have agreed to various combinations of sales, transportation, standby service and CD reduction. Columbia Gas Transmission Corporation (Columbia) is the

only major interstate pipeline company (that has operated primarily as a merchant) which not only has had its proposal for open access under Order No. 436 approved by Commission order(s) (with modifications), but also has accepted the Commission's decision and has enacted the contract demand reductions provided for in section 284.10 of the Commission's regulations. In fact, contract demand on Columbia's system totalling 4,290,780 dth was reduced effective October 8, 1986, by 101,277 dth (representing reductions by 10 LDC customers) to 4,189,503 dth. This represents a decrease of approximately 2.4 percent in contract demand for 1986.

Other major interstate pipelines have had their open access proposals approved (and modified) by the Commission, but have not yet accepted the certificates issued by the Commission. Within these open access proposals that have been approved by the Commission, the parties have modified the contract demand reduction scheme adopted by the Commission in Order No. 436 as promulgated in section 284.10 of the Commission's regulations to better reflect the operations of the particular systems. Two examples are in order: Texas Eastern Transmission Corporation (Texas Eastern) allows its firm sales customers the option of (a) signing new sales agreements after the issuance of a blanket transportation certificate to Texas Eastern and Texas Eastern's acceptance of such certificate or (b) retaining the existing sales agreements and the concomitant rights under section 284.10. If a firm sales customer were to sign a new sales agreement, such customer would not receive any reduction rights under section 284.10 (i.e., 100 percent reduction/conversion over five years). Instead, those customers signing new sales

agreements would be allowed to convert up to 50 percent of their firm sales entitlements to firm transportation over 10 years. Northern Natural Gas Company (Northern) allows the full 100 percent conversion/reduction over five years, but Northern allows a sales customer to combine its first two years' conversion rights into the first year (i.e., a 30 percent conversion). In consideration of this, Northern shall limit second-year conversion privileges (but not cumulative conversion rights) to the dollar equivalent of firm entitlement increases (sales, transportation and storage) that occur after the implementation of open access transportation, although conversion rights not exercised during the first year will be permitted during the second year.

In other related actions, the Commission ruled that § 284.10 CD reduction/conversion volumes were in addition to, not inclusive of, reductions agreed to by Columbia's customers prior to Order No. 436 in the so-called fraud and abuse settlement (Docket No. RM85-1-176, 36 FERC ¶ 61,269).

Second, at its February 18, 1987, meeting, the Commission approved an order requiring Transco to honor CD reduction requests made by Philadelphia Electric and Columbia Gas during the period Transco had initiated "new" § 311 transactions without benefit of a waiver of § 284.10 (Docket No. CP87-37-000).

Third, at the same meeting, the Commission voted to eliminate the "sole supplier" provision in Panhandle's tariff thus enabling its customers to obtain supplies from other sources while still being served by Panhandle (Docket No. RP82-58-000, et al.).

Fourth, Natural Gas Pipeline Company of America filed on February 17, 1987, in Docket No. CP87-206-000 an application under section 7(b) to reflect CD reductions to Iowa Electric and Iowa Southern of 7,281 MMBtu per day and 1,525 MMBtu per day, respectively.

Question 13: Are the LDCs moving to take complete advantage of the potential of Order No. 436 to reduce costs to all consumers? If not, please note how they might realize that potential.

Answer 13: On the basis of reports filed with the Commission, 842 transactions under NGPA section 311 by interstate pipelines on behalf of LDCs were active as of October 9, 1985; 1,591 such transactions were active as of February 19, 1987. Comparative volumes were 11.0 Bcfd and 25.6 Bcfd (est.), respectively. Additional activity can be expected as CD reduction/conversion is fully implemented. Also, state PUCs play a crucial role in the LDC's market behavior through their purchasing practices and transportation policies.

QUESTIONS FROM THE MINORITY

QUESTIONS FOR THE RECORD FROM
SENATOR JAMES A. McCLURE

FY 1987 Budget Assumptions

Question 1: Would you provide for the record a fiscal year 1987 baseline table by program indicating --

a. the budget authority and estimated outlays as appropriated by the Congress;

b. any proposed rescissions or deferrals; and

c. any anticipated supplemental appropriations.

Answer 1: The FY 1987 appropriation is $99,079,000. The estimated outlays are $102,487,000. The Commission has no proposed rescissions or deferrals and does not anticipate any supplemental appropriations.

Distribution by Program of the FERC's FY 1987
Budget Authority and Outlays
($000's)

Program	Budget Authority	Outlays
Natural Gas	$45,359	$ 46,919
Hydropower	27,968	28,930
Oil Pipeline	5,604	5,797
Electric Power	20,148	20,841
Total	$99,079	$102,487

Question 2: For each rescission, deferral or supplemental appropriation indicated in question 1, would you provide for the record its justification and status?

Answer 2: No rescissions, deferrals, or supplemental appropriations are anticipated.

FY 1988 Budget Request

Question 3: Would you provide for the record a fiscal year 1988 appropriations account baseline table (commonly referred to as the Holifield table), indicating the request (a) made by each program of the Commission; (b) made for each program by Commission to OMB, and (c) included in the President's proposed budget?

Answer 3: The Commission's FY 1988 requests to the Office of Management and Budget (OMB) and Congress are outlined by program below. The FY 1988 OMB request was adjusted subsequent to its submission to include funding for the January 1987 pay raise and the Federal Employee Retirement System (FERS).

Distribution by Program of the FERC's FY 1988
OMB and President's Budget Requests
($000's)

	FY 1988 OMB Request	FY 1988 President's Budget
Natural Gas	$ 47,499	$ 47,519
Hydropower	29,728	29,670
Oil Pipeline	5,730	5,778
Electric Power	21,117	21,033
Total	$104,074	$104,000
Pay Raise	+ 2,184	
FERS	+ 4,306	
FY 1988 OMB Request Adjusted	$110,564	

Question 4a: Would you provide for the record a table indicating--

a. any assumptions regarding carryover of fiscal year 1987 appropriations into fiscal year 1988?

Answer 4a: The Commission anticipates no carryover from FY 1987 to FY 1988.

Question 4b: Any proposed or anticipated supplemental appropriations?

Answer 4b: The Commission does not anticipate submitting any supplemental budget requests to the Congress during FY 1988.

Question 5: Would you provide for the record a list of any assumptions in the President's proposed budget that require legislation? In each case would you --

a. provide a statement of purpose;

b. provide the proposed language (if available) or indicate if, or when, the Administration intends to transmit such language to the Congress: and

c. indicate whether, in the judgement of the Administration, such legislation would be sought from the Energy and Natural Resources Committee or as a rider on an appropriation act.

Answer 5: The Commission's budget request for FY 1988 includes no assumptions that will require legislative action.

Question 6a: A new Federal Employee Retirement System was authorized by Public Law 99-335.

a. What are the assumptions being used regarding the budgetary effect of this new system?

Answer 6a: The Commission used the guidance provided in OMB Bulletin 87-2 to develop FERS costs estimates. Briefly summarized, they include the following assumptions:

- Post-1983 hires total 20 percent of the employee population in FY 1988 and the FERC will incur retirement costs of 23.94% of salaries for those FERS employees, (as opposed to 7% for Civil Service Retirement System (CSRS) employees.
- Forty percent of the CSRS employees will switch to the new system during the open season (July 1, 1987 - January 1, 1988). Employer contributions will total 24.94% of salaries for this population.

Question 6b: By appropriations account, what are the baseline and additional dollar costs?

Answer 6b: The baseline cost of FERS is $4.3 million. The additional dollar costs included in the President's budget are $3.5 million which reflect an anticipated absorption of $0.8 million.

Question 6c: By appropriation account, what, if any, effect on staffing levels is anticipated from the budget assumption that these additional costs will be absorbed?

Answer 6c: Staffing levels may have to be held below the authorized FTE ceiling to absorb portions of the FERS and pay raise costs. Actual staffing levels will be determined after assessing program needs to the potential for additional cost savings in the administrative areas.

Gramm-Rudman-Hollings Act Issues

Question 7: In the case of certain Federal programs and activities which receive offsetting fees, collections, etc., implementation of the Gramm-Rudman-Hollings Act would sequester budgetary resources on the basis of gross, rather than net, budgetary resources. Would you provide for the record --

a. a list of those programs or activities within the Commission that receive such off-setting fees, collections, etc. (whether directly or subject to appropriations);

Answer 7a: All fees and annual charges offset the appropriation in aggregate up to the amount of the appropriation. The collections exceeding our appropriation (which in FY 1988 are expected to be $900,000) are primarily the result of FERC collecting the costs of other Federal agencies for their efforts in administering Part I of the Federal Power Act. These funds will be credited to the general fund of the Treasury.

The chart below depicts fees and charges by program in FY 1988.

Fees and Charges for FY 1988

Fee Revenue	Estimate
Pipeline Certificates	$ 9,385
Pipeline Rates	3,759
Producer Certificates	604
Producer Rates	1,558
Wellhead Pricing	1,221
Oil Pipeline	355
Electric Power	2,721
Total Fee Revenue	$ 19,603
Annual Charges Revenue	
Hydropower	$ 30,570
Natural Gas	30,992
Oil Pipeline	5,423
Electric Power	18,312
Total Annual Charges	$ 85,297
Total Revenue	$104,900

Question 7b: an indication if it is proposed to change the treatment of offsetting receipts;

Answer 7b: There is no proposal to change the treatment of these receipts.

Question 7c: a description of such program or activity, including an indication of whether such fees, collections, etc., are for services provided for others (either Federal agencies or others);

Answer 7c: The Commission does not perform reimbursable work for other Government agencies or any other parties.

Question 7d: an analysis of whether the sequester of such budgetary resources may inhibit the provision of such services provided for others.

Answer 7d: Since the Commission does not engage in reimbursable work, there is no effect on the provision of services for others.

Canadian Gas Costs

Question 8a: In December 1986 the Commission changed the way it allows U.S. pipelines to flow through the costs of Canadian natural gas. Why did the Commission make this change?

Answer 8a: In December 1986, the Commission issued Opinion No. 256, Natural Gas Pipeline Company of America (Natural), in which it ordered Natural to remove certain (Canadian) costs from its demand charge which would not be recoverable through such a charge if the costs were associated with domestic production. The Commission issued this opinion so that the rate treatment by U.S. pipelines of their costs for imported and domestic gas supplies would be the same.

For the past decade the cost of Canadian supplies of natural gas has been priced by the Canadians and passed through by U.S. pipelines on a commodity cost basis. Passing through gas costs on the same basis that they are priced is known as the "as-billed" method of pass through. Recently, contracts for Canadian supplies have been restructured from a purely commodity pricing scheme to a two-part demand-commodity structure. The demand-commodity pricing structure shifts the marketing risks from the seller of the gas because it provides for payment of a demand charge irrespective of the quantity of gas purchased. The lower the commodity charge the easier it is to market gas in the short term regardless of its total cost or marketability.

In light of the recent restructuring of Canadian contracts the Commission changed its method of handling Canadian gas costs in order to ensure that Canadian and domestic supplies are afforded an equal opportunity to compete in U.S. markets. Commodity pricing places the risk of marketing the commodity on the seller, for if

the price is too high, gas is not purchased and resold, in this case, by a U.S. pipeline. The flow-through of the prices on an as-billed basis ensures that the price signal is carried through to the marketplace.

Demand-commodity rate structures are common in the pipeline industry. The relative proportion of costs in the demand charges of domestic pipelines are, of course, determined by the FERC. The demand-commodity rate structure of the Canadian supplies is more heavily weighted to demand than any of the rate structures currently approved by the FERC for project financed domestic pipelines. Thus, because of the difference in the rate design utilized by the FERC and the Canadians, there is a stronger incentive to buy Canadian gas than to buy U.S. pipeline supplied gas if U.S. pipelines are permitted to continue to pass through the cost of Canadian supplies on an "as-billed" basis.

In Natural the Commission changed from the "as-billed" method for Canadian supplies in order to remove any marketing advantage afforded Canadian supplies because of the different rate designs. Thus, U.S. pipeline supply and Canadian supplies can compete for U.S. markets on equal footing.

Question 8b: Does this decision deny Canadian gas exporters the ability to recover any of their costs of providing natural gas to U.S. consumers?

Answer 8b: No. The cost of Canadian supplies is governed by the contract between the supplier and the U.S. pipeline purchasing the gas. The FERC decision to change the way a U.S. pipeline flows through costs of Canadian supply does not affect the contract

governing the price U.S. pipelines have agreed to pay Canadian sellers for the imported gas. The contract terms are subject to scrutiny by the U.S. Economic Regulatory Administration.

Question 8c: In December 1986, the Commission changed the way it allows U.S. pipelines to flow through the costs of Canadian natural gas. Does this decision have the effect of making Canadian gas consumers pay for investments made to service U.S. gas markets?

Answer 8c: No. As mentioned earlier, the amount paid by U.S. pipelines for Canadian gas supplies is the subject of the contracts between them. The FERC decision in Natural does not affect the contractual arrangement made by the parties.

Question 8d: In December 1986, the Commission changed the way it allows U.S. pipelines to pass through the costs of Canadian natural gas. Does this decision reject the contracts which had been agreed to by the companies involved in accordance with both the Department of Energy's import guidelines and with Canadian regulations?

Answer 8d: No. The FERC decision is concerned solely with the pass through of costs incurred by Natural pursuant to contracts with Canadian suppliers. Moreover, the FERC has no authority to reject contracts to import Canadian Gas. Import contract scrutiny is performed by the U.S. Economic Regulatory Administration.

Question 8e: What is your assessment of the consequences of this decision on the short and long-term availability of Canadian gas to the U.S. market?

Answer 8e: The Natural decision will have no significant effect on the physical availability of Canadian gas to the U.S. market. For one thing, the reserves of Canadian natural gas are vast. Moreover, the Natural decision will not directly affect existing contracts between Canadian producers and U.S. pipeline purchasers: the decision applies only to the resale rates the U.S. pipelines charge their customers, not the rates paid by those U.S. pipelines to the Canadian producers.

The effect of the decision will be felt, however, in the resale market. This decision requires costs associated with production and gathering of gas to be billed as commodity costs since they are costs associated with obtaining the commodity. Canadian authorities permit their producers to load production and gathering costs into the demand charge--which is paid whether gas is purchased or not--even though those costs are not associated with investment assets. If the Canadian costs are allowed to be passed through to the pipeline's consumers on an "as-billed" basis, more costs would be loaded into the demand charge resulting in a lower commodity charge than domestic pipelines are permitted. A gas supply with a lower commodity charge is more attractive to the resale market than one with a higher commodity charge, even if the total price of each supply (commodity plus demand charges) is the same. Thus, with the pass through of Canadian gas costs tilted toward demand, U.S. consumers had an incentive to purchase gas from a pipeline that imports Canadian gas rather than from a pipeline that purchases domestic gas, for the pipeline cannot, according to Commission policy, load the same level of costs of domestic gas into the demand charge. By allocating more costs to the demand charge, the Canadian producers were thus able to insulate themselves from market risk to a greater degree than domestic producers are allowed.

The Natural decision promotes a fair-trade environment that will ensure that the costs of Canadian gas are treated in the same manner as those of domestic gas when determining resale rates. Pipelines purchasing domestic gas will thus be able to compete on an equal footing with pipelines importing Canadian gas.

Question 8f: In your opinion, will this decision lessen Canada's willingness to authorize new export facilities and volumes?

Answer 8f: The U.S. is Canada's prime export market. By the same token, Canadian supplies are important to the U.S. market. There is every reason to expect that this relationship will continue.

Fish and Wildlife Service MOU

Question 9: In your oral testimony you stated that you are preparing to enter into a Memorandum of Understanding with the U.S. Fish and Wildlife Service with respect to issues raised by the Commission's hydroelectric licensing program. Do you intend on coordinating this Memorandum of Understanding with the other relevant federal agencies, such as the National Marine Fisheries Service?

Answer 9: The Memorandum of Understanding (MOU), as contemplated by FERC, would deal with matters which are specific to dealings between the Commission and the Department of Interior, Assistant Secretary for Fish, Wildlife and Parks (Fish and Wildlife Service), such as: (1) parallel and integrated environmental assessments as an alternative to the current sequential approach; (2) agreements on target deadlines for our respective actions in the hydrolicensing process; (3) FERC's collection of fees to cover Fish and Wildlife Service costs in the hydrolicensing process; and (4) exchange of technical information between FERC and the Fish and Wildlife Service regional staff. As a separate matter we hope to establish similar MOUs with the NMFS, the Environmental Protection Agency, the Department of Agriculture Forest Service, and others.

QUESTIONS FOR THE RECORD FROM
SENATOR LOWELL WEICKER, JR.

Optional Expedited Certificate (OEC) Procedures
Under Order No. 436

Question 10: On what specific statutory authority does the Commission base its promulgation of the OEC procedures?

Answer 10: The optional certificate procedures are based on section 7 of the Natural Gas Act. See 15 U.S.C. § 717(e) (1982). The procedures are designed to lower regulatory barriers to entry into the gas sales market. See 10 C.F.R. §§ 157.100 - 157.106 (1986). The procedures require that an applicant be willing to assume economic responsibility for its ventures. Thus, as a consequence of the pipeline's bearing the financial risk of failure, instead of its customers, the Commission established a rebuttable presumption that the new service would be required by "the present or future public convenience and necessity." See Natural Gas Act, § 7(e), 15 U.S.C. § 717f(e) (1982); 18 C.F.R. § 157.104(c) (1986) (rebuttable presumption).

Under the optional certificate procedures, the risk of underutilization is assigned to the pipeline. The pipeline, therefore, has every incentive to properly estimate those factors that the Commission has traditionally considered. Thus, if the pipeline builds excess capacity because it overestimates the available market or supply of gas, it cannot pass the resulting loss to the ratepayers. Similarly, if the pipeline misjudges the market and builds facilities that are undersized, then it will be vulnerable to competition, thus also benefiting the ratepayers.

The use of this rebuttable presumption is consistent with the Commission's responsibility under section 7(c) of the Natural Gas

Act. See 15 U.S.C. § 717f(c) (1982). The purpose of section 7(c) is to "empower the Commission to prevent uneconomic extensions and waste." S. Rep. No. 948, 77th Cong., 2d Sess. 1 (1942), quoted in F.P.C. v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, 13 (1965). This legislative purpose is realized by the optional procedures completely insulating ratepayers from a pipeline's uneconomic investments.

Finally, the optional procedures, which seek to encourage competition, comport with section 7(g) of the Natural Gas Act - the Congressional recognition that the Commission can grant certificates for competitive service. See 15 U.S.C. § 717(g) (1982) ("Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural gas company").

Question 11: Under what circumstances will the Commission hold evidentiary hearings on the issue of need in OEC proceeding? Would hearings ever be ordered, despite the applicant's willingness to adopt rates consistent with subpart E?

Answer 11: The Commission will hold an evidentiary hearing on an optional certificate application when there is an issue of material fact to be resolved. Citizens for Allegan County v. F.P.C., 414 F.2d 1125 (D. C. Cir. 1969). Determination as to whether an issue of material fact exists commences with consideration of the presumptions in 18 CFR § 157.104(c). One of the presumptions in an optional certificate proceeding is that "the proposed new service is or will be required by the present or future public convenience and necessity." If the party seeking to

rebut this presumption alleges facts that are material to the presumption, and if those facts are in dispute, then an evidentiary hearing will be held to resolve the issue.

Need is an issue appropriately considered in a certificate proceeding. F.P.C. v. Sunray DX Oil Co., et al., 391 U.S. 9 (1968). The price at which gas might be sold or at which a transportation service might be rendered is but one of the elements to be considered in determining whether a service is required by the public convenience and necessity. Thus, an evidentiary hearing might be ordered on an optional certificate application despite an applicant's willingness to adopt rates consistent with Subpart E. Even if the rate is consistent with 18 C.F.R. § 157.103, if there is a rebuttal of the presumption in 18 C.F.R. § 157.104(b) that that service is or will be required by the public convenience and necessity, a hearing may nevertheless be required to resolve the issue of fact which is the subject of the rebuttal.

Question 12: When will the Commission act on the numerous requests for a hearing on the Iroquois application?

Answer 12: At the present time, consideration of the requests for hearing on the Iroquois application has not been scheduled. On January 30, 1987, Iroquois filed an amended application. Comments on that filing are due on March 9, 1987. Those comments will have to be analyzed before Commission consideration. Also, the Commission is presently preparing a draft environmental impact statement (DEIS) for the application filed by Iroquois Gas Transmission System in Docket No. CP86-523-000. The DEIS is expected to be completed in late summer or early fall of this year. Once the DEIS is available, local hearings will be held on this matter.

Question 13: What specific procedures does the Commission intend to use in OEC proceedings?

Answer 13: An application for an optional certificate will be analyzed by the Commission's staff to ensure that it complies with the requirements of 18 C.F.R § 157.102 (Contents of application and other pleadings) and 18 C.F.R. § 157.103 (Terms and conditions; other requirements) of the Commission's regulations, including compliance with all environmental requirements. Notice of the application will be published in the Federal Register and the Commission's staff will analyze any resulting petitions to intervene. If the intervenors have raised issues of fact that are material to the decision whether or not to issue a certificate, then the case will be set for a formal evidentiary hearing. Otherwise, the application will be considered on the basis of the pleadings filed in the case.

Question 14: What burden must an intervenor meet to rebut the OEC presumption that a pipeline is needed?

Answer 14: 18 C.F.R. § 157.104(c)(3) establishes the following presumption for optional certificates:

> (c) Presumption. If an application complies fully with the requirements of § 157.102 and § 157.103, it is presumed, subject to rebuttal that:
>
> * * *
>
> (3) the proposed new service is or will be required by the present or future public convenience and necessity.

The nature of the burden to be met to rebut the presumption would ultimately have to be resolved on a case-by-case basis, in the factual context in which it arises. The Preamble to the final rule, however, provides significant guidelines, based on long

standing Commission precedent, as to the statutory standards applicable to issuance of certificates under section 7 of the Natural Gas Act:

> In one of the earliest Commission proceedings concerning an application for a certificate of public convenience and necessity, the Commission defined public convenience and necessity as meaning "a public need or benefit without which the public is inconvenienced to the extent of being handicapped in the pursuit of business or comfort or both -- without which the public generally in the area involved is denied to its detriment that which is enjoyed by the public of other areas similarly situated." Kansas Pipe Line & Gas Company, et al., 2 FPC 29 (1939). The Commission determined that the public convenience and necessity involved certain minimum requirements upon which the applicant must make a favorable showing.
>
> Specifically, the applicants must show that (1) they possess a supply of natural gas adequate to meet those demands which is reasonable to assume will be made upon them; (2) there exist in the territory proposed to be served customers who can reasonably be expected to use such natural gas service; (3) the facilities for which they seek a certificate are adequate; (4) the costs of construction of the facilities which they propose are both adequate and reasonable; (5) the anticipated fixed charges or the amount of such fixed charges are reasonable; and (6) the rates proposed to be charged are reasonable. These factors are still relevant today (although the emphasis on specific factors has changed as conditions in the industry have changed). Applicants for certificates of public convenience and necessity must file information relevant to the determination of these issues. 18 C.F.R. § 157.14.
>
> Although the final rule does not require an affirmative showing on each of these factors, nevertheless, the rule is designed to ensure that each of these requirements will be satisfied as they apply to individual projects. With respect to several of these requirements, the rule represents a natural extension of the evolving Commission policy.

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42,208, 42,474 (October 18, 1985), FERC

Statutes and Regulations, Regulation Preambles 1982-1985, ¶ 30,665, 31,582.

In other words, Order No. 436 has established a presumption that the above-enumerated standards have been met when the facts alleged fall within the narrow parameters established for optional certificates. The presumption can be effectively rebutted by a showing that these enumerated standards have not been met. Such a showing would consist of: (1) an allegation that one of more of these standards has not been met; and (2) facts in support of the allegation. If the facts advanced to rebut the presumption are in dispute, and if those facts are material to determination of whether one or more of the standards has been met, then an evidentiary hearing will be required to resolve the facts in dispute.

Question 15: Can the Commission reasonably assume the adoption of new subpart E rates ensures that a construction project will serve the public convenience and necessity?

Answer 15: The rate provisions of subpart E were designed to ensure accountability for a proposal by imposing the risk of project failure on the applicant. Since the risk of under-utilization is assigned to the pipeline, the pipeline itself has every incentive to estimate properly those factors that the Commission has traditionally considered in the exercise of its regulatory oversight when presented with a certificate application.

Under this approach, if the pipeline builds excess capacity because it overestimates the available market or supply of gas, it cannot pass its resulting loss to the ratepayers. This provides a strong incentive for the pipeline to be accurate in its estimates and lowers regulatory barriers to new market entry. For these

reasons, in Order 436, the Commission found that it is reasonable to presume, subject to rebuttal, that a construction project subject to the subpart E rates will serve the public convenience and necessity.

Question 16: Does the Commission recognize that subpart E rates do not necessarily mean that the applicant is at risk?

Answer 16: Rates filed for new services under the optional certificate procedures are required to be one-part, volumetric rates. In other words, the rates must recover costs only to the extent projected units of service are actually purchased. The rates may not include a demand charge, minimum bill, minimum take provision, or other provision that will guarantee revenue. This places virtually the entire risk of a project on the applicant. To the extent the applicant cannot sell the service, the applicant cannot pass through costs.

The only exception to these requirements is that an applicant may include a reservation charge for firm transportation service consistent with the conditions of 18 C.F.R. § 284.8.

It is the Commission's opinion that a reservation charge should be allowed in the circumstances described so that customers will not have an incentive to overbook pipeline capacity. If the customers do not have to pay to reserve capacity, they may have a strong incentive to reserve all of the pipeline's capacity or at least more capacity than they need. The Commission further believes that although a reservation charge will assure some recovery of fixed costs, it will not significantly insulate the pipeline from risk, or shift accountability away from the pipeline.

First, a reservation charge does not insulate the pipeline from as much risk as a demand charge would. Moreover, before it can impose a reservation charge, the pipeline must find customers who will agree to pay a reservation fee to book firm transportation service, and the customers can determine, in negotiations with the pipeline, the duration of the service. Thus, customers may well have sufficient options available to avoid paying a reservation fee by shifting risk to the pipelines during the negotiation process. Finally, a reservation fee will not be permitted unless it is evident that the fee is in fact designed to elicit responsible nominations for firm pipeline capacity and is not simply a cost avoidance measure. See Great Lakes Gas Transmission Company, et al., 37 FERC ¶ 61,270 at page 61,798 (1987).

Question 17: Has the Commission considered limiting the use of the OEC procedures to applications for new service that involve only limited construction of new pipeline or ancillary facilities?

Answer 17: The Commission has not considered such a limitation. However, the optional certificate procedures are part of the Commission's effort to revise aspects of its regulations so as to eliminate distortion in the operation of the competitive gas sales market, including aspects of its regulations that impede the ability of buyers and sellers to deal directly with each other. These procedures are designed to lower regulatory barriers that have impeded pipeline efforts to enter new markets in competition with other pipelines. If the optional certificate procedures were narrowed to include only limited construction or ancillary facilities, their effectiveness in achieving these goals would be

limited largely to proposals by existing pipelines to build small spurs to serve a customer or small market area already served by another pipeline or distribution company.

Question 18: Will the environmental impact statement (EIS) for an OFC project address the issues of need and project alternatives? If so, in what detail?

Answer 18: An optional certificate must first be a major Federal action having a significant impact on the quality of the human environment before an EIS will be prepared. Once that decision is made, however, the EIS must address the issues of project alternatives, including the alternative of "No Action". The EIS must evaluate and compare all reasonable alternatives and must briefly discuss the reasons why other alternatives were eliminated from detailed study. This comparative analysis is performed to allow a clear basis for choice among options by the Commission.

The EIS must also discuss the issue of need. However, normally the EIS gives recognition to the analysis of gas supply, markets, rates and financing issues which occurs in other elements of a proceeding at the Commission. The EIS usually recognizes that it is the Commission's finding, based on this proceeding, that a project is required by the public convenience and necessity that determines project need.

Question 19: Why hasn't FERC promulgated the NEPA regulations mandated by the Council on Environmental Quality?

Answer 19: The Commission's predecessor, the Federal Power Commission, adopted regulations in 1972 to implement the National Environmental Policy Act (18 C.F.R. §§ 2.80-2.82 1986). These regulations, with minor amendment, remain in effect. In addition, in 1979 the Commission issued a notice of proposed rulemaking (NOPR)

consistent with the regulations of the Council of Environmental Quality (CEQ). Although the Commission did not issue the NOPR as a final rule, the Commission's practice has been to follow the spirit of the CEQ regulations. At my direction, staff is in the process of drafting a new comprehensive NOPR for Commission consideration that would adopt the CEQ regulations with only those modifications necessary to reflect practices at the Commission.

Question 20: Will the Commission stay the issuance of any certificate issued under the OEC procedures pending resolution of important legal questions?

Answer 20: Under the Administrative Procedure Act, 5 U.S.C. § 705, the standard for grant of a stay by an administrative agency is "whether justice so requires". Pursuant to that standard, the Commission has broad discretionary power to stay its orders. In exercising that discretion, it looks to the primary purposes of the statutes it administers. See Ozark Gas Transmission System, 17 FERC ¶ 61,235 (1981). With respect to the Natural Gas Act, those purposes encompass ensuring continued availability of natural gas in interstate commerce for eventual sale to consumers, at just and reasonable rates.

The Commission follows a general policy of denying motions for stays of its orders. This policy is based upon the need for definitiveness and finality in administative proceedings. Arkansas Louisiana Gas Company, Docket No. RP80-91, et al., 23 FERC ¶ 61,324 (1983).

The key element in the Commission's determination of whether to grant a stay is whether the moving party has demonstrated that it will be irreparably injured in the absence of a stay. Arkansas Louisiana Gas Company, supra. In addition, if such a finding of

irreparable injury is made, the Commission must balance the potential harm to the petitioner with the interests of the applicant and its customers, and the overall public interest that may be adversely affected by a postponement of Commission action. See Commonwealth Gas Pipeline Corp., et al., 29 FERC ¶ 61,054 (1984); Attorney General's Manual on the Administrative Procedure Act., p. 106 (1947).

The Commission will continue to apply these traditional criteria in assessing petitions for a stay of orders issued pursuant the optional certificate procedures, and will stay such orders if the circumstances and competing equities so require.

QUESTIONS FOR THE RECORD FROM
SENATOR MARK O. HATFIELD

Northwest Pipeline Corporation Interim Settlement

Question 21: On February 4, 1987, the Commission approved an interim settlement filed by Northwest Pipeline Corporation to transport natural gas under conditions outlined in Order 436. This approval is set to expire on May 1, 1987, or when the Commission approves a permanent transportation agreement consistent with Order 436, whichever comes first. Because the uninterrupted transportation of gas is vital to residential and industrial users in the region, please outline the Commission's plan to rule on Northwest's application expeditiously.

Answer 21: The Commission's plan is to consider the proposed settlement of Northwest Pipeline Corporation's Order No. 436 blanket certificate application prior to May 1, 1987.

APPENDIX II

Responses to Additional Committee Questions From the Department of Agriculture, Forest Service

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QUESTIONS SUBMITTED BY
SENATOR J. BENNETT JOHNSTON

FOREST SERVICE

TIMBER

While the timber sales level remains consistent with 1987 appropriation levels, there is a shift of volume between regions. Particularly, the Pacific Northwest sale level decreases from 5.2 billion to 4.8 billion board feet.

1. Question: Can you explain the reasons behind this shift and the expected ramifications of such changes?

   Answer: The shifts are very slight. The Region 6 offer volume in FY 1987 is 46.3 percent of the National total and in FY 1988 it is 43.4 percent. The R-6 5-year average is 42.6 percent. The R-6 actual harvest volume in FY 1986 as a percent of the National total was 42.1 percent. Region 6 has been selling more than it harvests.

   In FY 1986 and again in FY 1987 the Region 6 reoffer volume has been increased by the appropriations bill. This has meant that some timber sales have been offered and sold ahead of schedule, depleting the amount of timber in the pipeline for sale in subsequent years. The proposed sales level will be sufficient to maintain timber harvest levels.

The President's budget calls for an annual timber sale program of 11.1 billion board feet, but current harvest levels are 11.8 billion board feet.

2. Question: Given this trend, increased housing starts, and decreased Canadian timber supply, will this level of timber sales be adequate?

   Answer: The FY 1988 offer volume will be sufficient. Nationally, uncut volume under contract is 26 BBF, or about 2.5 years of harvest. This varies by Region. Region 6 in FY 1986 harvested 4.965 BBF and offered 5.366 BBF of timber.

   During the ten year period FY 1977-FY 1986, the volume of timber sold exceeded the volume harvested in seven years. The total volume sold in that period exceeded the volume harvested by 11.1 BBF. The Administration is proposing to sell about the same volume of timber as in FY 1986 (11.0 BBF) and FY 1987 (11.2 BBF). This is above the 9.7 BBF average annual harvest for the last ten years. Just as sales volumes exceeded harvest volumes during the housing recession of the early 1980s, harvest volumes should be allowed to exceed sales volumes during this period of increased consumption of wood products.

3. Question: If the timber sales level is remaining constant for FY 1987, why are the timber sales administration and management dollars increasing from $184 to $211 million?

Answer: Funding and proposed timber sales levels in the NFS appropriation for FY 1987 and FY 1988 are as follows:

	Appropriated FY 1987	Estimated FY 1988
MMBF prepared ..... MMBF	9,822	9,989
Timber Sales Administration and Management (Thousand Dollars)	184,139	211,196

About $14 million of the proposed funding increase in timber sales administration and management is due to the pay act and to implementation of the new Federal employees retirement system.

Besides the 167 MMBF increase in timber sales prepared over FY 1987 levels, the proposed increase in timber sales administration and management funding will pay for an increase in timber inventory from 7.1 million acres to 16.5 million acres, an increase in silvicultural examination from 4.7 million acres to 5.4 million acres, and an increase in timber harvest from 11.5 BBF to 11.8 BBF.

The Forest Service's mandate is to manage the National Forests for a variety of uses. While timber sales remain constant, and timber sales administration dollars increase, recreation funds will most likely decrease if proposed fee legislation is not passed, funds for wildlife and fish drop slightly, and the budget for endangered species habitat improvement decreases 64 percent.

4. Question: Can you explain this seeming lack of regard for your multiple use mandate?

Answer: We do not have a lack of regard for our multiple use mandate. We are managing the National Forests for multiple purposes, using many different methods to accomplish our objectives. Though there are slight decreases in some programs, this does not mean the American people are denied the substantial supply of goods and services these programs produce. The FY 1986 Report of the Forest Service shows extensive use of the National Forests by hunters, fishermen, water users, outfitters, church and youth camps, summer homes, permittees, and a wide variety of other users.

A quick review of our recreation program clearly shows we are meeting our multiple use mandate. The Forest Service provides twice as many recreation visitor days of use as does the National Park Service. Part of the reason for this amount of use is the accessibility of the National Forests. We maintain about 9,500 recreation sites; manage 32 rivers as components of the Wild and Scenic Rivers system; manage 19 National Recreation Areas, Scenic Areas, and Monuments; maintain 374 National Recreation trails as part of our 96,000 mile trail system; and manage over 100 administratively designated scenic botanical, geological, and archaeological areas.

Many of the National Forest plans that have come out so far are calling for large budget increases.

5. Question: Does this year's budget reflect management priorities of the forest plans?

   Answer: The program budget process uses much of the same information generated through forest planning, but is much more specific and focused on a 1- to 5-year time period. The Forest plan is not necessarily fully implemented in the budget, though projects funded in the budget are consistent with the opportunities described in the plan.

6. Question: If budget levels for the individual forests are not met, how will the plans be changed to reflect the decreased budgets?

   Answer: Forest plans are 10-year direction documents, and are implementable over the entire planning period (10-15 years). The heart of the Forest plan is the management direction to be applied to future projects and activities. Activities and projects that cannot be implemented as tenetatively scheduled in the plan due to budget restraints would be delayed or rescheduled until a later time in the planning period. If project and activity schedule changes due to differences between implementation costs displayed in the plan and the funds actually appropriated significantly alter the long-term relationship between levels of multiple use goods and services projected in the plan, amendment may be required. Schedule changes to make adjustments that do not significantly alter long-term relationships can usually be accommodated without amendment.

7. Question: Do you have a policy on which programs will be cut if budgets are decreased?

   Answer: If budgets are decreased and the Department is given discretion to allocate the reductions, the same priorities found in the Administration's budget would be followed on a national basis.

OMB's publication of the Budget of the United States Government for 1988 states on page 2-52, "Current law distributes Federal 'profits' that often do not exist, and creates an incentive for State and local governments to advocate unprofitable and uneconomic uses of Federal resources."

8. Question: How unprofitable and uneconomic are Federal timber sales?

Answer: Federal timber sales are not unprofitable or uneconomic on a national basis, though there are some locations where we do not recover the cost of preparing and administering the sales..

There have been many efforts by industry, environmental groups, the Congress (GAO and the Congressional Research Service), and the Executive branch to determine the degree of unprofitability of individual sales. The most promising work to date is probably the Timber Sales Program Information Reporting System developed by the Forest Service and adjusted to include a number of suggestions made by GAO.

While many of the analyses of Forest Service timber sales reach different policy conclusions, there are some areas of general agreement:

- Because of the multiyear nature of a Federal timber sale, comparing costs and receipts in any one year involves some degree of distortion. Having said this, most studies conclude that the timber program covers its direct costs on a nationwide basis.

- There are individual timber sales which are unprofitable by any analysis. There are reasons why such sales are made and it is a matter of one's policy priorities whether the goals achieved through unprofitable sales are worth the cost.

- In considering the total effect of Forest Service timber sales on the Federal Treasury, it is necessary to consider the receipt sharing payments made to the States. In some years, the "profits" of the timber program have been more than offset by these payments on a national basis, and that is clearly the case with individual sales. That is the reason for the statement quoted from the President's Budget Message which explains the need to go to a net receipts basis for calculating Payments to States.

9. Question: Does current Forest Service policy discourage uneconomic sales?

Answer: Current Forest Service policy is to offer sales that are most cost efficient in meeting the established National Forest management objectives. Not all timber sales return a direct financial profit to the Treasury but every effort is made to ensure that the sale is cost efficient and the least costly way to meet established management objectives.

10. Question: Do you feel that, if we could all agree on what "uneconomic" actually is, we should allow uneconomic sales on our National Forests in the light of overwhelming budget deficits?

Answer: We should not allow sales that are not the most cost efficient in meeting the objectives set forth in the forest plans. The Administration would not support legislation to eliminate below-cost sales, since these sales may be the most efficient method for reaching some other management objective.

The last two appropriations bills have directed the Agency to reduce unit costs, especially in the forest road program.

11. Question: Have you reduced road costs?

Answer: The FY 1986 Continuing Resolution contained language directig a 5 percent gross unit cost reduction from FY 1985. This was to be accomplished nationally and in each Forest Service Region. This was achieved nationally and 8 of 9 Regions also achieved or exceeded the reduction goals. The FY 1986 Report of the Forest Service contains this information.

12. Question: Is there more that might be done to reduce costs?

Answer: The FY 1987 continuing resolution has already directed a further 5 percent decrease in average road cost per mile, compared to the adjusted FY 1985 average cost. This further reduction in unit costs has been incorporated into target unit costs set for each Region. The results will not be available until the end of FY 1987. Therefore, whether much more can be done to reduce unit costs beyond reductions already requested is yet to be determined.

The National Forest road system has long been a source of controversy. You propose to spend $198.6 million on the forest road program. This is $20 million more than last year's request.

13. Question: Can you explain why you're asking for $20 million more when the harvest level has remained the same?

Answer: The key point is that the forest road program in support of timber is based on offered volume rather than harvest volume, and the offer volume has increased from the 1987 to 1988 request. The FY 1987 President's Budget contained a request for $178.5 million in the Forest Road Program. Of this amount, $143.8 million was to support a timber offer volume of 10.0 billion board feet. In the FY 1988 President's Budget, $198.6 million has been requested in the Forest Road Programwith $166.5 million to support a timber offer volume of 11.1 billion board feet.

Timber offered for sale has increased because of increased harvest rates. In FY 1987, the estimated harvest volumes for FY 1987 and FY 1988 were 11.2 billion board feet and 11.2 billion board feet, respectively. In FY 1988, the estimated harvest volumes for FY 1987 and FY 1988 are 11.5 billion board feet and 11.8 billion board feet, respectively.

You propose a dramatic change in the manner by which payments to States are collected by using net receipts instead of gross. This will result in a $248 million dollar decrease in payments to the States.

14. Question: What impact will this decrease have in the States which now rely on this income particularly for schools?

    Answer: The proposal will require States and counties to identify alternate sources of revenue for county road and school systems. However, Payments in-Lieu of Taxes (PILT) will be funded and some counties may receive increased PILT payments that will somewhat offset losses from the 25 percent fund.

    We are developing a data base from FY 1986 figures that we will use to estimate potential payments to States and counties based on a net receipts calculation. Such an estimate will be available in about six weeks.

Your budget assumes increases in revenues due to a change in your fee structure.

15. Question: Could you explain where fees would be charged where they aren't currently, and where they might be raised?

    Answer: The Forest Service has about 9,500 recreation sites such as campgrounds, picnic grounds, swimming beaches, boat launches etc. Under current legislation we now charge at about 2,100 sites. Restrictions in Land and Water Conservation Fund Act (L&WCF), Section 4(b), prevent us from charging at the remaining sites. The Act's restrictions, for example, forbid charging fees at campgrounds not having "tent or trailer spaces, drinking water, access road, refuse containers, toilet facilities, personal collection of the fee by an employee or agent of the Federal agency operating the facility, reasonable visitor protection, and simple devices for containing a campfire (where campfires are permitted)."

    Under our proposed revision of the L&WCF, these restrictions would be removed. We would anticipate that we would charge at about 1,000 additional sites and at about 220 heavily used areas where we provide facilities and services.

    Our current average (median) charge for overnight camping is about $4.50 per night. We anticipate the average charge for the new sites would be around $3.00 and for heavily used areas would average about $2.00 per vehicle. We adjust fees annually to make them comparable with fees at other facilities. This law will not change that.

16. Question: If this fee request is granted do you anticipate requests for more fee authority in the future?

    Answer: We do not plan on any general rise in campground fees other than what may be necessary to keep up with inflation. If our proposed admendments to the L&WCF are enacted into law, we would not anticipate the need for any additional authority.

The President's Budget calls for $45 million for the Tongass National Forest Timber Supply Fund, and a sales level of 374 million board feet. In the meantime, an emergency rate granted to Alaska Lumber and Pulp Company reduced the stumpage price of Alaska cedar sawlogs from $1,058.27/MBF to $1.22/MBF. The highest price that Alaska Lumber and Pulp pays for stumpage is $2.26/MBF, and the lowest is $.50/MBF. The Forest Service in Alaska tells us these prices will most likely continue for at least another 5 years.

17. Question: While understanding the limits you are under with existing legislation, does it concern you to be selling 374 million board feet of timber a year at prices which could not possibly begin to cover your costs?

    Answer: We are concerned about the current market situation in Alaska. We have taken steps to reduce Tongass timber supply fund costs. We feel it is important to the economically depressed Alaskan economy to maintain a timber sale program, to bring offer volume in line with harvest volume, and to comply with terms of the 50-year timber sale contract. While we currently have low stumpage prices because of the depressed market, the overall 50-year timber sale terms are positive and have been a benefit to Alaska's economy.

The Forest Service Budget discontinues almost all financial assistance to the States with the exception of Pest Management. Timber supply studies, most notably the recently completed Southern study, show that we will become increasing dependent on supply from non-industrial private landholders, particularly in the South. These lands have been traditionally undermanaged and underutilized.

18. Question: Could you explain how the discontinuation of assistance to the states will affect our ability to tap this supply?

    Answer: Consumption of softwood products continues to outpace the rate of net annual growth of the Nation's forests. Investments in reforestation and management must increase if forest owners are to take advantage of expanding wood markets. Non-industrial private landowners tend not to make these investments.

    The budget acknowledges that there is an appropriate Federal role in continued research and technology transfer. If the States, industry, and non-industrial landowners are unwilling to make the investments necessary to exploit the opportunities displayed in the Southern study, there will be less wood available and higher prices. If that is the case, it is still more appropriate for users of wood products to bear the burden of higher prices than for all taxpayers to bear the burden of higher taxes.

The President's Budget sharply reduces funds for firefighting from $125 million in 1987 to $1 million in 1988.

19. Question: Could you explain the nature of that request?

    Answer: The FY 1988 request for $1 million will be followed by a supplemental request after the fire season to reimburse actual costs.

QUESTIONS SUBMITTED BY
SENATOR JAMES A. McCLURE

20. Question: Would you provide for the record a fiscal year 1987 baseline table by Bureau indicating for each appropriations account--

a. the budget authority and estimated outlays as appropriated by the Congress;

b. any proposed rescissions or deferrals; and

c. any anticipated supplemental appropriations.

Answer: This information is shown on the following spreadsheet:

Page 1 - 31-Mar-87

1 3/31/87 - 1:38 PM (PAYDIS2)
2
3 NOTE: SHOWS 1987 APPROPRIATED OUTLAYS DRAWN FROM
4 BUDGET APPENDIX
5

6 7 8 9 FY 1988 - DESCRIPTION	87APPBA APPROP BUDGET AUTHORITY	87APPBA APPROP OUTLAYS	TRANSFER FROM UNOBL BALANCE LAND ACQ	TRANSFER OF BUDGET AUTHORITY	SUPPLEMENT/ RESCISSION	87APPREV REVISED BUDGET AUTHORITY
10						
11						
12 FOREST RESEARCH	128,882	123,621	1,381	(4,500)	0	124,382
13				—2/		
14 STATE AND PRIVATE FORESTRY	58,946	58,479	0	(797)	0	58,149
15						
16 NATIONAL FOREST SYSTEM	1,158,254	1,183,647	14,798	12,697	0	1,178,991
17						
18 CONSTRUCTION	251,736	246,249	0	0	0	251,736
19						
20 HIGHWAY CONSTRUCTION - MOUNT ST. HELENS	(9,915)	5,592	0	0	9,915	9,915
21						
22 LAND ACQUISITION (LWCF)	52,236	33,483	(27,878)	0	(49,838)	9,886
23						
24 ACQ. OF LANDS FOR NF SPECIAL ACTS	966	944	0	0	0	966
25						
26 ACQ. OF LANDS TO COMPLETE LAND EXCHANGES	895	895	0	0	0	895
27						
28 APPROPRIATED TRUST FUNDS	98	98	0	0	0	98
29						
30 RANGE BETTERMENT FUND	3,644	3,642	0	0	0	3,644
31						
32 YOUTH CONSERVATION CORPS	(1,000)	0	0	0	0	(1,000)
33						
34 Subtotal, Persanent Apprns, Working Funds	148,584	144,110	0	(11,500)	0	125,784
34 Subtotal, Persanent Apprns, Pymts to Sts.	273,879	559,725	0	0	0	273,879
36						
37 TOTAL, PERMANENT APPROPRIATIONS	414,563	783,835	0	(11,500)	0	482,663
38						
39 TOTAL, COOPERATIVE WORK, FOREST SERVICE	197,616	198,185	0	0	0	197,616
40						
41 REFORESTATION TRUST FUND	38,000	29,742	0	0	0	38,000
42						
43 TOTAL, REGULAR FOREST SERVICE	2,387,868	2,588,244	(16,891)	(4,500)	(39,115)	2,278,853
44			—1/	—2/		
45 OTHER ACCOUNTS	0	497	0	0	0	0
46 TRANSFER FUND ACCOUNTS	(188,667)	0	(0)	(0)	(0)	(188667)
47 GRAND TOTAL, FOREST SERVICE	2,387,868	2,588,741	(16,891)	(4,500)	(39,115)	2,278,853

—1/ Transferred to the Department of Agriculture

—2/ Transferred to CSRS, Department of Agriculture

21. Question: For each rescission, deferral or supplemental appropriation indicated in question 1, would you provide for the record its justification and status?

Answer: The 1987 Current Estimate includes the following program changes:

-- A rescission was proposed for Land Acquisition totaling $49,030,000 ($42,430,000 from 1987 appropriations and $6,600,000 from prior year unobligated balances). Additional purchase of private lands by the Federal Government will be postponed in order to: (1) minimize reducing the current taxable land base for State and local government revenue purposes, (2) permit the Forest Service to concentrate its attention and limited resources on maintaining and improving their current extensive land base, and (3) help achieve the deficit reduction goals of the Balanced Budget and Deficit Control Act of 1985. Since the Congress did not agree to the rescission request, the money was made available for allocation on March 16, 1987.

-- $27,070,000 of Land Acquisition funding will be deferred and transferred to other Forest Service appropriations and other USDA agencies to be used for pay and FERS.

-- $797,000 appropriated for Lake Tahoe within the State and Private Forestry appropriation will be deferred and transferred to the National Forest System appropriation for pay and FERS costs.

-- $11,900,000 of purchaser elect program road construction funding will be deferred and transferred to National Forest System to be used for pay and FERS.

-- A 1987 Supplemental is proposed for liquidation of contract authority provided in the 1987 Appropriations Act for road construction in the Mount St. Helens National Volcanic Monument.

FY 1988 Budget Request

22. Question: Would you provide for the record a fiscal year 1988 appropriations account baseline table, indicating the request (a) made for each program to Assistant Secretary, (b) made by the Assistant Secretary of the Secretary, (c) made by the Department to OMB, and (d) included in the President's proposed budget?

Answer: This information is shown on the following spreadsheet:

1 3/31/87 - 2:00 PM (BBITEM8)

USDA - FOREST SERVICE
ITEM 8 -- BUDGET REQUEST HISTORY TABLE

	FY 1986 ACTUAL	FY 1987 APPROP.	FY 1988 AGENCY REQUEST	FY 1988 DEPARTMENT ALLOWANCE	FY 1988 PRESIDENT'S BUDGET
FOREST RESEARCH:					
Fire and Atmospheric Sciences Research	7,716	8,946	8,380	8,038	8,336
Forest Insect and Disease Research	20,186	21,500	25,256	22,232	21,828
Forest Inventory and Analysis	16,316	17,322	19,215	17,009	16,893
Renewable Resources Economics Research	4,378	4,379	6,963	4,998	4,648
Timber Management Research	21,582	23,382	27,428	24,298	23,681
Watershed Management & Rehabilitation Research	14,858	16,118	13,486	16,861	15,628
Wildlife, Range, and Fish Habitat Research	9,872	11,491	12,348	18,634	11,439
Forest Recreation Research	2,849	2,377	2,681	2,380	2,427
Forest Products and Harvesting Research	17,560	18,364	23,838	19,486	18,298
Special Projects, Competitive Grants	6,586	6,998	4,588	4,998	0
TOTAL, FOREST RESEARCH	129,127	128,882	148,317	129,838	122,218
STATE AND PRIVATE FORESTRY:					
Forest Pest Management:					
Federal Lands:					
Surveys and Technical Assistance	10,924	11,343	14,742	14,742	13,742
Insect and Disease Suppression	7,866	8,182	12,972	12,972	10,810
Special Projects	1,191	1,298	2,869	2,869	1,219
Cooperative Lands:					
Surveys and Technical Assistance	1,783	1,876	2,877	2,877	2,877
Insect and Disease Suppression	6,363	6,588	3,258	3,258	0
Subtotal, Forest Pest Management	28,329	31,021	38,118	35,118	27,886
Fire Protection	13,832	13,688	12,879	9,778	4,778
Forest Management and Utilization:					
Forest Resource Management	4,981	5,298	4,993	3,294	0
Wood Utilization	913	1,888	1,316	1,316	0
Seedlings, Nursery, and Tree Improvement	1,721	1,888	2,212	2,212	0
Urban Forestry	1,983	1,925	1,869	531	0
Subtotal, Forest Management and Utilization	9,518	9,925	10,298	7,353	0
Special Projects:					
Boundary Waters Canoe Area	2,854	2,888	3,888	3,888	2,888
Pinchot Institute for Conservation Studies	198	298	0	0	0
Lake Tahoe (PL 96-586)	1,298	1,488	0	0	0
Subtotal, Special Projects	4,442	4,488	3,888	3,888	2,888
TOTAL, STATE AND PRIVATE FORESTRY	35,321	38,946	61,379	31,841	35,434

3/31/87 - 2:00 PM (BBITEM8)

USDA - FOREST SERVICE
ITEM 8 -- BUDGET REQUEST HISTORY TABLE

	FY 1986 ACTUAL	FY 1987 APPROP.	FY 1988 AGENCY REQUEST	FY 1988 DEPARTMENT ALLOWANCE	FY 1988 PRESIDENT'S BUDGET
NATIONAL FOREST SYSTEM:					
Land and Resource Protection:					
Minerals Area Management:					
Locatable Minerals	9,163	8,819	13,942	12,264	11,487
Leasable Minerals	13,463	13,056	14,126	12,297	11,435
Common Variety Minerals	2,157	2,788	3,497	3,001	2,792
Geology	2,381	1,736	3,219	3,023	2,885
Subtotal, Minerals Area Management	27,164	26,319	34,784	30,585	28,519
Real Estate Management:					
Land Exchange & Adjustment	5,282	5,182	6,291	6,291	5,414
Land Classification, Status & Planning	2,879	1,637	2,887	2,887	2,478
Special Uses	7,187	7,357	18,735	18,735	9,242
Geometronics	5,319	5,749	6,181	6,181	5,309
Subtotal, Real Estate Management	19,976	19,845	26,894	26,894	22,443
Land Line Location	27,399	26,363	32,698	32,698	27,383
Maintenance of Facilities	14,184	14,735	29,678	29,678	16,905
Forest Fire Protection:					
Fire Presuppression	138,192	143,881	166,396	155,846	143,845
Fuels Management	13,477	11,795	9,262	5,758	7,771
Subtotal, Forest Fire Protection	151,669	154,796	175,658	161,604	151,616
Fighting Forest Fires	166,652	125,000	1,000	1,000	1,000
Cooperative Law Enforcement	6,639	6,660	7,178	7,178	5,696
Forest Road Maintenance	61,856	61,778	81,184	79,684	65,752
Forest Trail Maintenance	9,537	11,000	15,313	15,313	11,526
Total, Land & Resource Protection	485,638	446,488	394,571	374,818	329,360
Renewable Resource Management & Utilization:					
Sales Administration and Management:					
Timber Resource Inventory Planning	12,823	13,280	17,277	17,277	17,277
Silvicultural Examination	19,296	20,670	28,280	28,280	28,280
Sales Preparation	89,312	99,489	186,268	186,268	186,268
Harvest Administration	53,676	50,560	59,459	59,459	59,459
Subtotal, Sales Administration & Management	174,987	184,139	211,196	211,196	211,196

3/31/87 - 2:00 PM (88ITEM8)

USDA - FOREST SERVICE
ITEM 8 -- BUDGET REQUEST HISTORY TABLE

	FY 1986 ACTUAL	FY 1987 APPROP.	FY 1988 AGENCY REQUEST	FY 1988 DEPARTMENT ALLOWANCE	FY 1988 PRESIDENT'S BUDGET
				-	
Reforestation & Stand Improvement:					
Reforestation	26,552	22,311	25,987	25,987	5,337
Timber Stand Improvement (TSI)	24,038	21,833	37,768	36,988	19,635
Nursery and Tree Improvement Operations	14,546	14,549	20,518	20,378	14,667
Subtotal, Reforestation & TSI	65,128	58,693	84,273	83,273	39,639
Recreation Use:					
Recreation Management	82,216	90,824	103,500	96,849	42,360
Wilderness Management	7,520	10,030	11,933	11,738	9,637
Cultural Resource Management	9,281	9,368	15,060	14,548	12,292
Subtotal, Recreation Use	99,017	110,222	130,493	122,327	64,289
Wildlife and Fish Habitat Management:					
Wildlife & Fisheries Admin. & Resource Coord.	22,698	25,272	32,786	33,592	28,622
Wildlife Habitat Improvement	6,448	6,488	7,847	5,653	4,256
Fish Habitat Improvement	1,886	1,745	3,038	2,182	1,453
Endang., Threat. & Sensitive Species Hab.Imp.	2,368	3,505	1,522	1,182	1,387
Anadromous Fish	3,695	4,535	3,698	2,651	2,286
Subtotal, Wildlife & Fish Habitat Management	37,887	41,537	48,891	45,188	37,924
Range Management:					
Range Vegetation Management	23,231	24,355	29,426	28,821	24,822
Range Forage Improvement	1,833	581	1,849	383	243
Range Structural Improvement	1,859	188	1,138	781	495
Wild Horses & Burro Management	262	275	286	286	261
Noxious Weed Control	1,389	1,400	1,550	1,466	1,058
Subtotal, Range Management	26,894	26,799	33,441	30,937	26,879
Soil, Water and Air Management:					
Soil, Water, & Air Operations	21,237	24,038	34,707	33,579	27,104
Soil & Water Resource Improvement	2,988	3,125	2,000	2,000	2,000
Soil & Water Inventories	6,299	6,065	4,825	4,825	4,825
Subtotal, Soil, Water & Air Management	30,524	33,228	41,532	40,404	33,929
Total, Renewable Resource Mgmt. & Util.	432,657	454,818	549,826	533,317	413,856
General Administration	251,229	256,996	277,967	276,843	272,581
TOTAL, NATIONAL FOREST SYSTEM	1,168,924	1,158,294	1,222,364	1,184,178	1,016,417

3/31/87 - 2:00 PM (88ITEM8)

USDA - FOREST SERVICE
ITEM 8 -- BUDGET REQUEST HISTORY TABLE

	FY 1986 ACTUAL	FY 1987 APPROP.	FY 1988 AGENCY REQUEST	FY 1988 DEPARTMENT ALLOWANCE	FY 1988 PRESIDENT'S BUDGET
CONSTRUCTION:					
Construction of Facilities:					
Research Construction	642	340	1,608	1,608	608
Construction for FA&O	15,316	8,083	26,498	10,131	7,586
Recreation Use Areas Construction	10,895	16,909	26,647	9,458	7,780
Subtotal, Construction of Facilities	26,853	25,332	54,753	21,197	15,894
Forest Road Construction	180,935	228,803	208,292	208,292	198,625
Forest Trail Construction	6,866	7,301	15,226	13,726	7,024
Forest Roads Purchaser Construction	0	0	(117,799)	(117,799)	(117,799)
Mt. Elden Work Center	0	300	0	0	0
TOTAL, CONSTRUCTION	214,654	261,736	278,271	243,215	221,543
HIGHWAY TRUST FUND - Mount St. Helens	0	(9,915)	0	0	0
LAND ACQUISITION (L&WCF)	31,356	52,236	3,907	3,907	3,907
ACQ. OF LANDS FOR NF SPECIAL ACTS	744	966	966	966	966
ACQ. OF LANDS TO COMPLETE LAND EXCHANGES	1,086	895	990	990	990
APPROPRIATED TRUST FUNDS	12	90	90	90	90
RANGE BETTERMENT FUND	3,635	3,644	3,750	3,750	3,750
OPERATION & MAINT. OF RECREATION FACILITIES	0	0	0	0	52,000
YOUTH CONSERVATION CORPS	(3,234)	(1,000)	0	0	0
TOTAL, APPROPRIATED FUNDS	1,595,859	1,665,689	1,714,834	1,618,175	1,457,389

1 3/31/87 - 2:00 PM (88ITEM8)

USDA - FOREST SERVICE
ITEM 8 — BUDGET REQUEST HISTORY TABLE

	FY 1986 ACTUAL	FY 1987 APPROP.	FY 1988 AGENCY REQUEST	FY 1988 DEPARTMENT ALLOWANCE	FY 1988 PRESIDENT'S BUDGET
179 PERMANENT APPROPRIATIONS, WORKING FUNDS					
180 Expenses, Brush Disposal	52,936	47,835	54,438	54,438	54,438
181 Licensee Programs: Woodsey/Smokey	95	100	100	100	100
182 Restoration of Forest Lands & Improvements	176	100	100	100	100
183 Timber Purch. Roads Constructed by FS	22,911	15,434	21,037	21,037	21,037
184 Timber Salvage Sales	29,677	26,000	18,635	18,635	18,635
185 Tongass Timber Supply Fund	51,802	45,815	45,379	45,379	45,379
186 Operation and Maintenance of Quarters	5,352	5,400	5,500	5,500	5,500
187					
188 Subtotal, Working Funds	153,949	140,684	145,189	145,189	145,189
189					
190 PERMANENT APPROPRIATIONS, PAYMENTS TO STATES:					
191 Payment to Minnesota	1,432	716	716	716	716
192 Payment to Counties, National Grasslands	21,842	9,356	18,366	18,366	18,366
193 Proposed Legislation	0	0	0	0	(6,601)
194 Net, National Grasslands	21,842	9,356	18,366	18,366	3,765
195 Payments to States, National Forest Fund	474,310	263,887	285,863	285,863	285,863
196 Proposed Legislation	0	0	0	0	(263,488)
197 Net, National Forest Fund	474,310	263,887	285,863	285,863	21,575
198					
199 Subtotal, Payments to States	497,584	273,879	296,145	296,145	25,956
200					
201 TOTAL, PERMANENT APPROPRIATIONS	651,533	414,563	441,334	441,334	171,245
202					
203 COOPERATIVE WORK, FOREST SERVICE (Trust Fund)					
204					
205 Cooperative Work - KV:					
206 KV Reforestation	67,114	91,494	110,873	110,873	110,873
207 KV Timber Stand Improvement	18,742	28,091	32,013	32,013	35,199
208 KV Other	70,236	35,546	54,635	54,635	54,635
209 Subtotal, Cooperative Work, KV	156,092	155,131	197,521	197,521	200,707
210					
211 Cooperative Work, Other	46,425	42,485	49,662	49,662	49,662
212					
213 TOTAL, COOPERTIVE WORK, FOREST SERVICE	202,517	197,616	247,183	247,183	250,369
214					
215 REFORESTATION TRUST FUND	30,305	30,000	30,000	30,000	30,000
216					
217 TOTAL, REGULAR FOREST SERVICE	2,480,214	2,307,868	2,432,551	2,336,692	1,998,923

23. Question: Would you provide for the record a table by Forest Service appropriations accounts indicating --

    a. any assumptions regarding carryover of fiscal year 1987 appropriations into fiscal year 1988?

    b. any proposed or anticipated supplemental appropriations?

    Answer: We assume a normal carryover in our two-year and no-year appropriations. Proposed supplementals for FY 1987 are shown in the answer to question 20. We anticipate a supplemental request after the 1988 fire season for actual FY 1988 firefighting costs.

24. Question: Would you provide for the record a list of any Forest Service program assumptions in the President's proposed budget that require legislation?

    a. provide a statement of purpose;

    b. provide the proposed language (if available) or indicate if, or when, the Administration intends to transmit such language to the Congress; and

    c. indicate whether, in the judgement of the Administration, such legislation would be sought from the Energy and Natural Resources Committee or as a rider on an appropriation act.

    Answer: The information requested follows:

AUTHORIZING LEGISLATION

PAYMENTS TO STATES--NET RECEIPTS

The President's budget includes a proposal to convert from sharing of gross receipts to sharing of net receipts after expenses for all receipts derived from activities on the National Forest System, except recreation use which would remain unchanged.

The Federal Government would deduct from National Forest and National Grassland receipts (except receipts from recreation use) those program costs which are necessary to realize and to continue those receipts. The share of receipts paid to State or county governments (25 per cent) would be calculated after costs are deducted. It is estimated that the proposal will reduce payments to States and counties from Forest Service receipts in FY 1988 from $296 million to $26 million.

Proposed legislation to convert the basis for payments to States and counties from a share of gross receipts to a share of net receipts is being developed. This proposal will be transmitted to the Congress in 1987. It is uncertain to which committees of the House and Senate the proposal will be referred. The Administration did not propose appropriations language to effect this change.

RECREATION USER FEES

Background

During the past several years, there has been considerable discussion about increasing National Forest System recreation user fees to help close the gap between Forest Service costs of providing recreation opportunities to the public and the current amount of fees collected from recreation users. New legislation would be necessary to materially increase revenues.

The primary authority for collecting recreation fees on the National Forest System is the Land and Water Conservation Fund Act of 1965, as amended. Under this act, the Forest Service collects recreation user fees for campsites which meet specified standards, for boat launching sites with mechanized boat lifts, and for other specialized recreation sites, facilities, equipment, and services. Entrance fees are not charged for any National Forest.

Recreation-generated revenues also come from recreation special uses, such as ski areas and recreation residences. These are collected under the Organic Act of 1897 and Occupany Permits Act of 1915.

The FY 1988 Forest Service recreation budget requires that $52 million from recreation receipts be used for National Forest recreation management. To meet the increased collections necessary to help support the Forest Service recreation program in FY 1988, legislation would be necessary to provide additional recreation fee authorities.

The Draft Legislation

The proposed legislation was transmitted to the Congress on March 12. It would authorize the Secretary of Agriculture to charge recreation use fees for certain outdoor recreation sites, facilities or services provided in the National Forest System. This provision would amend section 4 of the Land and Water Conservation Fund Act of 1965, as amended, to provide authority to charge use fees at more sites and areas and for more services. Therefore it would likely be referred to the Senate Energy and Natural Resources committee.

The proposed legislation would return all collected recreation revenues to a special fund for use by the Forest Service in providing outdoor recreation opportunities. No change in recreation special use authorities is anticipated, except that these receipts would also be returned to the special fund. The collected fees would continue to be subject to the twenty-five percent fund.

A new Federal Employee Retirement System was authorized by Public Law 99-335.

25. Question: a. What are the assumptions being used regarding the budgetary effect of this new system?

Answer: This information is shown in the enclosed attachment A, OMB Bulletin 87-2.

Question: b. By appropriation account, what are the baseline and additional dollar costs?

Answer: The FY 1988 request includes the estimated cost in each appropriation account of the new Federal Employees Retirement system. These estimated costs are:

Appropriation	President's Budget	FERS Portion
Forest Research	$ 122,212	$ 4,113
State and Private Forestry	35,434	781
National Forest System	1,016,417	40,559
Construction	221,543	6,180
Land Acquisition	3,907	144
Other Appropriated Funds	57,796	0
Working Funds	145,189	3,407
Payment to States	26,056	0
Cooperative Work	250,369	6,504
Reforestation Trust Fund	30,000	0
Total	$1,908,923	$61,688

Question: c. By appropriation account, what, if any, effect on staffing levels is anticipated from the budget assumption that these additional costs will be absorbed?

Answer: This will have no effect on staffing levels.

Attachment A
OMB Bulletin No. 87-

Assumptions for Calculation of
Increased Retirement Costs

A. General assumptions.

(1) Participation - It is assumed that 40 percent of CSRS enrollees will switch into the new FERS between July 1, 1987 and January 1, 1988. (This assumption is incorporated in the percentages shown in table 1 of this Attachment.)

(2) Thrift plan utilization - Under the plan, agencies will contribute 1 percent of payroll for every FERS enrollee even if the employee contributes nothing. In addition, agencies must match 100 percent of employee's first 3 percent of pay contributed to the plan and 50 percent of the next 2 percent. Agency contributions to the Federal Retirement Thrift Investment Board for the thrift plan will be assumed to be static, in percentage terms, over the 5-year estimating period.

Agencies are to use the following actuarial projections regarding employee contributions to the thrift plan for FY 1987-1992. Specifically, they are to utilize a 3 percent total contribution on behalf of post-1983 hires, and a 4 percent total contribution on behalf of the population switching into FERS. (These rates include the 1 percent contribution required for every FERS enrollee and incorporate the impact on post-1983 hires' contributions of changes in employer matching contributions, maximum contributions, and effective dates included in the Omnibus Budget Reconciliation Act of 1986.)

(3) Timing of enrollment - Under FERS, agency contributions to social security (i.e., to the Federal old-age and survivors and disability insurance trust funds, known as OASDI), and the civil service retirement fund will begin January 1, 1987 for post-1983 hires. Contributions to the Thrift Investment Board for the thrift plan will begin the first pay period in April, 1987 for these employees. For estimating purposes, it is assumed that half of the current CSRS enrollees who will switch will do so July 1, 1987. The remaining half will do so December 31, 1987.

(4) FERS-covered population - The amount of agency contributions will be determined by applying the percentages spelled out in sections C through N of this attachment to the payroll attributable to the 3 populations identified as post-1983 hires, switchers, and CSRS enrollees. These populations may vary by agency but should not be substantially different from the following Government-wide averages.

Table 1. Government-wide Participation in FERS/CSRS
(Percentage Of Total Payroll)

	Fiscal Year					
	1987*	1988*	1989	1990	1991	1992
Post-1983 hires	12	20	23	26	29	32
Switchers	4	28	31	30	28	26
Total FERS Population	16	48	54	56	57	58
CSRS Enrollees	84	52	46	44	43	42
Total Retirement	100	100	100	100	100	100

* Adjusted to reflect timing of enrollment, as discussed above.

Agencies should use the above proportions of total payroll for purposes of cost estimates unless they can demonstrate convincingly to their OMB representative that other proportions are more appropriate.

Under FERS, agency contributions will be made to the civil service retirement and disability fund for the basic annuity, to the OASDI for social security, and to the Thrift Investment Board for the optional thrift plan.

Gramm-Rudman-Hollings Act Issues

In the case of certain Forest Service programs and activities which receive off-setting fees, collections, etc., implementation of the Gramm-Rudman Hollings Act would sequester budgetary resources on the basis of gross, rather than net, budgetary resources.

26. Question: Would you provide for the record:

a. a list of those programs or activities within the Forest Service that receive such off-setting fees, collections, etc. (whether directly or subject to appropriations);

b. an indication if it is proposed to change the treatment of offsetting receipts;

c. a description of such program or activity, including an indication of whether such fees, collections, etc., are for services provided for others (either Federal agencies or others); and

d. an analysis of whether the sequester of such budgetary resources may inhibit the provision of such services provided for others.

Answer: This information requires further analysis, and will be provided later.

Certain Federal statutes specifically specify the Federal and State apportionment of certain collection, revenues, etc. Implementation of a sequester under the Gramm-Rudman-Hollings could alter the apportionments of such funds.

27. Question: Would you provide for the record:

a. a list of such collection and distributions by the Forest Service, indicating their statutory authority;

b. a table indicating by State the fiscal year 1987 and 1988 distributions that would occur?

c. a statement of Department policy regarding the disposition of any sequestered funds, in the event of a sequester (for example, would such funds be deposited in the General Fund or placed in escrow for eventual distribution and, if so, when would such distribution occur)?

Answer: This information requires further analysis, and will be provided later.

28. Question: Is the 11.1 billion board feet contained in the President's budget the same as the Agency request for FY 1988? If not, what program level did you request?

Answer: The 11.1 billion board feet contained in the President's budget is the same as the Forest Service request for FY 1988.

For the past three years (since 1984) consumer demand for lumber products in the United States has set new records while the domestic lumber industry has only recently begun to see some recovery from the worst markets in history.

29. Question: What projections in the demand did you use in arriving at your sale program request?

Answer: The requested timber sell level is based on many factors. Historical program levels, volumes currently under contract, budget considerations, and individual forest capability within forest plan constraints--all are considered in proposing a sale program level. Projected harvest in any given year is primarily based on expected demands.

30. Question: Does your recommended timber sale program level of 11.1 bbf include a response to the upswing in demand over prior years?

Answer: Expected increase in demand for timber from National Forest lands can be met from the existing volumes currently under contract in the short term. That's why it is appropriate to maintain a 2-year historical level under contract available for harvest level under contract available for harvest. Currently, the Forest Service has 26 billion board feet (2.5 years at historical harvest rates) of timber under contract.

31. Question: If consumer demand remains high, what will be the effect on those consumers if the sales program remains constrained at 11.1 bbf?

Answer: Even if it remains at or near historically high levels, planned program sell, combined with the substantial volumes under contract, should provide adequate volume to meet expected demand.

32. and 33. Question: Can the sales program level be increased without exceeding growth rates from the "suitables acres" base recommended in draft and final forest plans? In other words, can we increase the sale program and still operate on a sustained yield basis?

Answer: Timber sale program levels could be increased significantly on many National Forests in some areas of the country without exceeding growth rates from the suitable acres. Given multiple use constraints, however, current programs are approaching sustainable levels.

The U.S. - Canadian agreement on softwood lumber exports from Canada should result in a reduction of supply or a slight increase in price which should result in the domestic industry being able to compete more fairly. It may even mean that we will be able to recapture some of the 15 percent of the market lost to the Canadians over the past 12 years.

34. Question: Does your sales program allow for any response in the event our industry does have the opportunity to pick up some more of the market?

    Answer: The National Forests provide about 20 percent of the total wood volume harvested annually in the United States. The level of harvest from the National Forests has not varied significantly for any extended period of time from an average of 10.3 billion board feet, over the past 27 years. Historically, lumber manufacturers have varied harvest on private lands to accommodate varying levels of demand.

    The current programs coupled with the volume of timber under contract, does provide purchasers the latitude to use National Forest timber to recapture a proportional share of the market lost to the Canadians.

The funding for harvest administration is based on a projected harvest of 11.8 bbf in FY 1988.

35. Question: Given that demand will remain high and the Canadian market share will probably decrease slightly, do you anticipate any possibility of another period of "desperation bidding" similar to that which occurred during the late 1970s and helped put our industry in a tailspin?

    Answer: Excessive bidding in the late 1970s was more the pressure of speculative competition than desperation over limited timber supplies. Many procedures, have been implemented since 1982 to discourage speculative bidding. These include increased down payments, mid-point payments, periodic payments, and down payment rates keyed to overbid levels.

36. Question: Could your sales program level coupled with a harvest level greater than sales offerings conceivably trigger a response to "false scarcity" of available stumpage that your program could likely create?

    Answer: So long as the National Forest sales programs remains near historical levels, there should not be a false scarcity reaction. With the volume of timber under contract it would take several years of significantly reduced sale programs to create a real shortage in National Forest timber available for harvest.

37. Question: How much of the 11.1 bbf will be products other than sawlogs?

Answer: It is difficult to predict how much of the total National Forest program in any given year will be products other than sawlogs, though we assume this will be in the historic range of 10-18 percent of total. As markets for certain products improve, such as pulp, forests will also adjust their program where possible to meet changing demands and take advantage of specific market conditions.

Projected need for National Forest timber are based on the anticipated demand for all uses of wood products. Locally, Forest Supervisors may vary their program product output mix to meet changing industry and other public needs.

38. Question: How does that figure compare to previous programs?

Answer: Historically, about 10-18 percent of the National Forest timber output has been in products other than logs. The Forest Service Timber Sale program has emphasized sawlog production.

39. and 40. Question: When you project the need for National Forest timber in relation to market demand forecasts, do you consider firewood and other similar products as a part of meeting the demand created by housing and other construction markets? If not, why are those figures not dealt with separately instead of providing a somewhat distorted picture of how much sawtimber is being harvested from the National Forests?

Answer: When we project the total volume needs for the National Forest System, we do consider that other products will make up a portion of the total demand. The softwood lumber market is directly related to the housing market. Since 80-88 percent of the total volume sold is sawtimber, the housing market is the major factor affecting projected demands for National Forest timber sales.

Program budgets and reports have always been put together on the readily understood and tracked concept of thousand board foot units (MBF). As the variety of uses of National Forest timber has increased--i.e. poles, pilings, shingles, pulp, firewood, fuel, fence posts, ties, peelers, flake and particle board and sawn boards--we have continued to convert to the common unit of measure, MBF, for convenience.

Because there is such a wide variety of wood products taken from the National Forests, and each of these products have a unique unit of measure that can mean different things in different parts of the country, the Forest Service and industry are jointly studying the option of converting all forest products sold and harvested to a cubic measurement system.

In North Idaho the study displays a significant increase (approximately 180 MMBF) in timber sale programs beginning in 1994. This increase is identified as the "forest plan preferred alternatives" and falls within the 15 year planning period for this round of plans.

41. Question: Are these increases planned for and authorized by the draft plans as published for the three North Idaho National Forests, or will the Forest Service have to revise the plans to permit this increase?

    Answer: The base harvest schedules on these draft forest plans do reflect an increase in the program beyond the first decade. However, the allowable sale quantity of a forest plan is for a 10-year period only. If it is necessary to increase that quantity, an amendment to the plan will be necessary. An amendment to the allowable sale quantity, which is the same as the base harvest schedule, would be consistent with the plan and the environmental statement.

The study acknowledges in several sections that the use of historic median harvest levels is "intended to serve as base lines or points of reference, not as an indication of future timber demand."

42. Question: Would the Forest Service please provide their current estimates for timber demand in North and South Idaho?

    Answer: The Forest Service has no recent estimates of timber demand in Idaho. Regions 1 and 4 are in the process of developing demand estimates based on RPA and other supply/demand work underway in the Region. These estimates will be used in conjunction with the Idaho Timber Supply Study in developing final forest plans. These will be provided to the committee when they are available.

43. Question: Also, would the Forest Service please provide a summary of current mill capacity for the market areas in North Idaho?

    Answer: Chuck Keegan, University of Montana, Bureau of Business and Economic Research, estimates that the current mill capacity for North Idaho is 1.45 billion board feet, based on 1985 data. It should be kept in mind, however, the historic utilization of gross mill capacity ranges from 75 to 95 percent.

Previously published Forest Service data, particularly "Idaho's State and Private Forest Resource" by Van Hooser and Green, has concluded that private non-industrial harvests cannot be maintained due to inventory depletion beyond the early 1990s. In fact, one study, "North Idaho's Private Wood Pile" by Alan Green, concludes that "the last big tree on private land in Clearwater County will be cut in about 1993." Yet the Report projects in North Idaho that inventory levels for private non-industrial ownerships decrease slightly in the base scenario."

44. Would the Forest Service explain this apparent discrepancy in their data.?

Answer: The information in "Idaho's State and Private Forest Resource" by Van Hooser and Green, and "North Idaho's Private Woodpile" by Green were based solely upon the net annual growth and annual removal of sawtimer on nonindustrial private lands collected for the year 1981.

The "Report on Idaho's Timber Supply" takes the same data collected in the year 1981 and updates this information to the year 1985. Then, using TRAS (a timber volume projection model) projections of harvest volumes, growth, and inventory are made into the future. This is a much better procedure upon which to make statements about future inventories on nonindustrial private lands.

Basically, the difference can be explained in terms of the amount of standing old growth volumes in 1981 (the inventory year) and relationship between increased growth on future stands as old growth stands are harvested. In other words, future net annual growth in total for nonindustrial private lands increases, and will exceed the sawtimber harvests predicted in the future.

The North Idaho area recognized in the Report is quite diverse. Certainly, it is difficult to conceive of this area as a single market. Seldom, if ever, are logs harvested in Boundary Country milled in Idaho County, or vice versa. One would also anticipate that availability of logs from different ownerships would differ significantly throughout the North Idaho area recognized by the Report.

45. Question: Would the Forest Service disaggregate the data for North Idaho into logical log market areas?

Answer: While it may have been desirable to analyze timber supply on a more specific geographic basis in the study, the basic data was neither available nor possible to obtain in a reasonable period of time. The information in the report will, however, be correlated to each individual National Forest and the marketing areas they represent in the course of developing final forest plans.

Several of the scenarios examined in the study reflect the potential for increased harvest from State and other public ownership. Most of this analysis is focused on the potential of the timber inventory on these ownerships to support higher harvest levels.

46. and 47. Question: Would the Forest Service please contact the agencies responsible for managing these ownerships, and report the practical changes necessary to realize these potential increases? Also, would the Forest Service provide their own professional assessment as to the likelihood of increased harvest from these ownerships?

Answer: The likelihood of increased harvests from these ownerships is discussed on pages 56, 57, and 58 of the report. This discussion is based on personal communications with officials of the State and Bureau of Land Management and reflects their evaluation of potential future increases. The Forest Service believes that they are in the best position to make these evaluations and has no basis to disagree with them.

The scenarios displayed in detail in the Report were, appropriately only a subset of all the scenarios examined. In order to better understand the full implications of the Report, we would like to examine some additional scenarios in more detail. Specifically, we are interested in obtaining detailed information for the following scenarios:

48. Question: a. Forest Service Current Direction Alternatives
b. Equity harvest with growth off of private and non-industrial lands.

Answer: The report did not discuss in detail all of the fifty-eight supply scenarios identified in the report primarily because of the voluminous document which would result. The intent was to examine in detail the most representative scenarios and allow the reader to use these scenarios as a basis for comparisons if he/she desired to explore some other scenario(s) using the applicable statistical data provided in the report.

The Forest Service will be provide a more detailed analysis of the two scenarios; however, this will require additional time to respond.

QUESTIONS SUBMITTED BY
SENATOR PETE DOMENICI

As you know, under current law 25 percent of Forest Service receipts are paid to States for distribution to the counties where the receipts originated. These monies are typically used for rural roads and schools. Last year, New Mexico received about $1.7 million. The Administration's budget would substantially reduce these payments to States.

49. Question: Under the Administration's proposal, by how much would payments to States be reduced in FY 1988?

Answer: The President's FY 1988 Budget indicated that payments to States would be reduced from $273.9 million in FY 1987 to $26.1 million in FY 1988.

50. Question: How can the Administration justify such a proposal when rural communities are facing these tough times?

Answer: This proposal is intended to respond to congressional direction to balance the budget provided by the Gramm-Rudman-Hollings Act. The burden of deficit reduction should be borne by all who share in Federal funds. These receipt-sharing programs were originally intended to support economic development in sparsely populated States and were often perceived as offsetting the effects of nontaxable Federal lands on local governments dependent on property taxes for support of local services. However, Congress enacted the Act of October 20, 1976 (90 Stat. 2662; Payments-in-Lieu-of-Taxes Act), that pays local governments annually for Federal lands within their jurisdictions. In addition, current law distributes Federal "profits" that often do not exist and creates an incentive for State and local governments to advocate unprofitable and uneconomic uses of Federal resources.

51. Question: By how much would this proposal reduce payments to New Mexico?

Answer: We are presently developing a data base that will be used to estimate by forest and State what the payments would be on a net receipt basis. This information should be available within about six weeks.

During the past Congress, a number of efforts were made to drastically cut the Forest Service road construction budget. I doubt there are very strong arguments for making deep cuts in the road budget as a means of reducing the deficit.

52. Question: As compared to the FY 1987 enacted level, what would be the impact on timber receipts over the next five years if Congress cut the road budget by 50 percent? What about a 25 percent cut?

Answer: Because of many factors, it is extremely difficult to predict what effects the reduction in Forest Service road budget will have upon receipts. For example, there are currently about 26 BBF under contract that are uncut as of October 1, 1986. That are 2.5 years of potential harvest still under contract. There could be two or three years of little or no effect and then a substantial reduction in receipts.

The National Forest timber sale program and the projected timber sale levels of 10-11 billion board feet are totally dependent over the next 10 years upon full access to the entire commercial forest land base. Without the access to these areas, the environmental effects upon existing accessed areas cannot be mitigated. The total timber sale levels will have to be substantially reduced if the necessary transportation system is not extended to unroaded released areas. The greater the delay, the more costly it becomes to make sales in existing areas or to extend roads into unroaded released areas.

A major part of the potential impact is directly dependent upon the domestic lumber market as it relates to the national economy. The demand for new housing, the lower level of interest rates, foreign exchange rates with Canada, the import of wood products, and the availability of other materials to National Forest timber purchasers will decide how timber purchasers will meet their supply and demands, and therefore determine National Forest timber receipts.

If the supply is reduced and there are not other sources of standing stumpage, the impact will be severe. If purchasers have alternative means of meeting their supply needs, the impact of reduced National Forest sale volume will be met by other means. Based upon these variables, it is extremely difficult to determine what impact a reduction will have on actual receipts. Reductions of 25 and 50 percent in the forest road program will have a significant effect upon the amount of volume available for harvest over the next three-to five-year period; therefore, the value of the available timber that is harvested will be reduced.

We recently prepared for the Congressional Budget Office an alternative that looked at the effects of a 25 percent reduction and a 50 percent reduction in the forest roads program in support of timber for the next three years. The 25 percent reduction would reduce timber sales over the FY 1988 to FY 1990 period by at least 7.4 billion board feet, while the 50 percent reduction would reduce timber sales by 12.9 BBF for the same period. These volume reductions were based upon the proposed President's budget level of 11.1 BBF per year for the FY 1988 to FY 1990 period. Since we looked at only the three-year period, we have not projected the impacts beyond this time frame. The larger the cuts, the longer the recovery period. It takes anywhere from 3-to 7 years of lead time to bring forest road and timber sale proposals along before the timber can be offered for a given year. Therefore, the impacts over a five year period would be larger.

Based upon the specific volume reductions, we estimate that the total value of timber sales not made and not available for harvest would be $642 million for the 25 percent reduction and $1.2 billion at the 50 percent reduction. The preliminary analysis was done very quickly with no review by the individual forests, and with quite a few assumptions. With more time and a greater definition of exactly what information is required, these estimates could be refined. However, the differences for the three year period would not change significantly from our estimate on the total national program.

53. Question: There are macroeconomic impacts from these reductions. What is your best estimate of the impact of these reductions on tax revenue collections? On the housing sector? What would be the impact on the Trade deficit?

Answer: The amount of volume sold and harvested from National Forests does not have a direct effect upon the amount of housing constructed. The amount of volume from National Forests that is available for harvest does have a direct effect upon the ability of timber purchasers to supply the lumber necessary to meet the housing market demands. If the reduced volume from National Forests is for one year, the increased stumpage may offset the reduced volume. If the reduction is for a large period of time, the values may never be recovered. Either other private timber lands or Canadian imports will make up the difference. Because Canadian imports make-up over 30 percent of the current market, and because private lands do not have sufficient capability to sustain an increase in volume for the next few decades, the Canadian imports with the present monetary exchange rate advantage will make up most of the differences.

As the recent recession showed, the more timber operators depend upon a source of raw material other than their own lands, the more difficulty they have staying in business. There are many other factors that cause mills to close, but those remaining mills that depend solely upon National Forest timber are the mills that are most likely to be totally affected by a substantial reduction in National Forest timber sales. The reduction in mill capacity, the increase in Canadian imports will more than offset the increased selling prices that might come about because of reduced National Forest timber sales.

A number of communities are dependent on their share of these receipts to meet local government needs.

54. Question: What would be the impact on selected communities that rely on timber receipts from these reductions?

Answer: The Forest Service is completing a study concerning the dependency of certain communities and industry on National Forest timber. We expect to have this study completed this spring.

We would expect that any industry and associated community that is totally dependent upon National Forest timber to be adversely affected by the projected reductions in both timber sale volumes and road construction work. The more even and prolonged the reductions, the greater the impacts. We would expect to see mills closed and employment opportunities decreased as a result of the projected 25 percent and 50 percent reductions in the forest road program. The resumption of the sales program some time in the future will not help the dependent industry or community over the immediate period of reductions.

QUESTIONS SUBMITTED BY
SENATOR FRANK H. MURKOWSKI

55. Question: How many Forest Service employees does the FY 1988 budget fund in Alaska? How many in the Tongass National Forest? How do these employment levels compare with recent years?

Answer: About 810 employees in Alaska are funded in the proposed FY 1988 budget, including 520 employees on the Tongass National Forest. Comparisons with previous years are:

	1986 Actual	1987 Est.	1988 Est.
Alaska	816	815	810
Tongass	528	525	520

I notice that the Forest Service request calls for reduction in funding for research on the relationships between Sitka Black Tailed Deer and old growth in Southeast Alaska.

56. Question: How much of a reduction is requested for FY 1988? What is the justification for this cut?

Answer: The President's FY 1988 budget would reduce funding for the Sitka Black-tailed deer research by $50,000. Highest priority Sitka Black-tailed deer studies will be retained in the President's FY 1988 budget.

57. Question: I am also submitting for the record a request that you provide me with a detailed breakdown of how Forest Service funds are being spent in Alaska.

Answer: This information is shown on the following spreadsheet:

3/31/87 - 11:32 AM (ALASKA)

FOREST SERVICE ALLOCATIONS IN ALASKA, FYS 1986-1988

NOTE: Answer to Senate Energy & Natural Resources Committee Question #57 (Murkowski)

	1986 ALLOCATION	1987 ALLOCATION	1988 INITIAL ALLOCATION
FOREST RESEARCH:			
Fire and Atmospheric Sciences Research	174	0	0
Forest Insect and Disease Research	245	266	281
Forest Inventory and Analysis	879	939	1,021
Renewable Resources Economics Research	0	0	0
Timber Management Research	474	521	533
Watershed Management & Rehabilitation Research	419	473	494
Wildlife, Range, and Fish Habitat Research	820	882	877
Forest Recreation Research	0	0	0
Forest Products and Harvesting Research	0	0	0
Special Projects, Competitive Grants	0	0	0
TOTAL, FOREST RESEARCH	3,011	3,081	3,206
STATE AND PRIVATE FORESTRY:			
Forest Pest Management:			
Total, Forest Pest Management	467	487	428
Fire Protection	316	345	187
Forest Management and Utilization:			
Total, Forest Management and Utilization	116	122	0
Special Projects:			
Total, Special Projects	0	0	0
TOTAL, STATE AND PRIVATE FORESTRY	899	954	615

1 3/31/87 - 11:32 AM (ALASKA)
2
3 FOREST SERVICE ALLOCATIONS IN ALASKA, FYS 1986-1988
4 NOTE: Answer to Senate Energy & Natural
5 Resources Committee Question #57 (Murkowski)

	1986 ALLOCATION	1987 ALLOCATION	1988 INITIAL ALLOCATION
NATIONAL FOREST SYSTEM:			
Land and Resource Protection:			
Minerals Area Management:			
Subtotal, Minerals Area Management, Op. Plans	1,386	1,178	1,609
Real Estate Management:			
Subtotal, Real Estate Management	523	648	801
Land Line Location	595	684	838
— Miles			
Maintenance of Facilities	473	490	528
Forest Fire Protection:			
Subtotal, Forest Fire Protection	447	488	487
Fighting Forest Fires	0	0	0
Cooperative Law Enforcement	49	49	28
Forest Road Maintenance	1,860	1,571	1,418
— Miles Maintained			
Forest Trail Maintenance	291	384	366
— Miles Maintained			
Total, Land & Resource Protection	4,824	5,412	6,075
Renewable Resource Management & Utilization:			
Sales Administration and Management:			
Subtotal, Sales Admin. & Mgmt., Offer MMBF —1/	745	813	838
Reforestation & Stand Improvement:			
Subtotal, Reforestation & TSI	58	453	79
Recreation Use:			
Subtotal, Recreation Use	4,260	4,242	6,678
— Million RVDs			

3/31/87 - 11:32 AM (ALASKA)

FOREST SERVICE ALLOCATIONS IN ALASKA, FYS 1986-1988

NOTE: Answer to Senate Energy & Natural Resources Committee Question 857 (Murkowski)

	1986 ALLOCATION	1987 ALLOCATION	1988 INITIAL ALLOCATION
Wildlife and Fish Habitat Management:			
Subtotal, Wildlife & Fish Habitat Management	4,018	3,933	4,547
Range Management:			
Subtotal, Range Management	0	0	0
Soil, Water and Air Management:			
Subtotal, Soil, Water & Air Management	1,705	2,146	1,685
Total, Renewable Resource Mgmt. & Util.	10,786	11,587	13,747
General Administration	3,864	4,791	4,498
SUBTOTAL, NATIONAL FOREST SYSTEM	19,474	21,798	24,328
CONSTRUCTION:			
Subtotal, Construction of Facilities	1,833	787	1,387
Forest Road Construction	1,858	1,588	2,078
— Miles			
Forest Trail Construction	114	368	347
— Miles			
Forest Roads Purchaser Construction			
— Miles			
TOTAL, CONSTRUCTION	3,805	2,567	3,732
LAND ACQUISITION (LWCF)	0	0	0
— Acres Purchased			
ACQ. OF LANDS FOR NF SPECIAL ACTS	0	0	0
— Acres Purchased			

3/31/87 - 11:32 AM (ALASKA)

FOREST SERVICE ALLOCATIONS IN ALASKA, FYS 1986-1988

NOTE: Answer to Senate Energy & Natural Resources Committee Question #57 (Murkowski)

	1986 ALLOCATION	1987 ALLOCATION	1988 INITIAL ALLOCATION
ACQ. OF LANDS TO COMPLETE LAND EXCHANGES	0	0	0
-- Acres Purchased			
TOTAL, APPROPRIATED FUNDS	26,389	28,392	31,873
PERMANENT APPROPRIATIONS, WORKING FUNDS			
Expenses, Brush Disposal	62	52	65
--Program Level/M Acres			
Licensee Programs: Woodsey/Smokey			
Restoration of Forest Lands & Improvements			
Timber Purch. Roads Constructed by FS			
--Program Level/Miles **(Included in PCP)			
Timber Salvage Sales	75	285	154
--Prog.Level/MMBF, Prep.&Offer (In Sales Admin.)			
Tongass Timber Supply Fund	46,540	42,770	44,318
--Prog.Level/MMBF, Prep.&Offer (In Sales Admin.)			
Road and Trail 10% Fund			
Operation and Maintenance of Quarters			
Subtotal, Permanent Apprns,Working Funds	46,677	43,827	44,537
PERMANENT APPROPRIATIONS, PAYMENTS TO STATES:			
Payment to Minnesota			
Payment to Counties, National Grasslands			
Proposed Legislation			
Net, National Grasslands			
Payments to States, National Forest Fund	376	UNK	UNK
Proposed Legislation			
Net, National Forest Fund			
Subtotal, Permanent Apprns,Pymts to Sts.	376		
TOTAL, PERMANENT APPROPRIATIONS	47,053	43,827	44,537

1 3/31/87 - 11:32 AM (ALASKA)
2
3 FOREST SERVICE ALLOCATIONS IN ALASKA, FYS 1986-1988
4 NOTE: Answer to Senate Energy & Natural
5 Resources Committee Question #57 (Murkowski)

	1986 ALLOCATION	1987 ALLOCATION	1988 INITIAL ALLOCATION
163 COOPERATIVE WORK, FOREST SERVICE (Trust Fund)			
164 Subtotal, Cooperative Work, KV	1,012	557	1,385
165			
166 Cooperative Work, Other	274	211	287
167 — Program Level			
168 Expenses, Road Maintenance Deposits (DAC)			
169			
170 TOTAL, COOPERATIVE WORK, FOREST SERVICE	1,286	768	1,672
171			
172 REFORESTATION TRUST FUND	0	79	112
173			
174 TOTAL, REGULAR FOREST SERVICE	74,728	72,266	78,194
175			
176			

QUESTIONS SUBMITTED BY
SENATOR CHIC HECHT

The Forest Service's Santini-Burton program has been very important to Lake Tahoe in the past. The program has allowed property owners who owned environmentally sensitive land to be bought out, and has also paid for erosion control projects in the Tahoe Basin.

58. Question: What do you see as the future of the Santini-Burton program?

Answer: The Santini-Burton Act P.L. 96-586, December 23, 1980, was enacted to protect the water quality of Lake Tahoe. It provided for the sale of BLM lands in Nevada and the acquisition of environmentally sensitive lands in the Lake Tahoe Basin. The following table is a summary of appropriations and acquisition activity under this Act.

FY	Cases	Appropriation ($)	Acres Acquired	Cost ($)
1981	0	--	--	--
1982	0	6,700,000	--	--
1983	190	10,000,000	3,409	8,519,500
1984	230	10,000,000	1,563	7,212,405
1985	294	16,802,000	1,727	8,801,900
1986	1,369	7,289,000*	638	7,771,715
1987	--	7,000,000	--	--
Total	2,083	57,791,000	7,337	32,305,520

*Initial appropriation of $3,000,000 reduced to $2,853,000 by Gramm-Rudman-Hollings and includes supplemental of $4,436,000 to replace transfer of $4,435,900 for insect control.

The cost of acquiring the total remaining properties in the Lake Tahoe Basin is about $117 million. The State of Nevada is expected to expend $23 million and California approximately $45 million.

Sales of BLM-administered lands in Nevada have been approximately $26.5 million. By the terms of the authorizing legislation, authorization is limited to the amount received for lands sold. Therefore, funds appropriated to date exceed the amount authorized by the bill. As a result of the authorizing limitation, acquisition funds are not requested in the FY 1988 budget, and appropriated FY 1987 funds are slated for rescission or deferral.

59. Question: Now that the Nevada voters have approved a separate Nevada-run Tahoe land acquisition program, do you see the Federal program placing more emphasis on erosion control and less on land acquisition?

Answer: There is a need to continue high priority watershed restoration work in the Lake Tahoe Basin to meet targets set by the Tahoe Regional Planning Agency and the State Water Quality Control Board. Both grant monies to local jurisdictions and appropriations to the Forest Service for restoration work on acquired lands is needed. A backlog of over 2,100 acres of disturbed National Forest lands require watershed improvement work at a estimated cost of $25 million. We expect to continue to emphasize reduction of sediment in the Lake Tahoe Basin.

Continued emphasis needs to be given to erosion control projects, especially on acquired sensitive lands. The FY 1988 President's budget includes $566,000 dollars for mitigating water pollution problems in the Lake Tahoe Basin. See page 193 of the FY 1988 Explanatory Notes.

60. Question: The administration has proposed a major rescission in the Santini-Burton program in the President's budget. Assuming the Congress fails to agree to that rescission request, when would the money once again start to flow into the program?

Answer: If the Congress fails to agree to the rescission request the money would be available in March 1987.

QUESTIONS SUBMITTED BY
SENATOR JEFF BINGAMAN

61. Question: Can you please provide the Committee with a breakdown of how cultural resource funding has been allocated to the various Regions? There is concern in my State that there has been a disproportionate share going to Regions along the East and West Coast.

Answer: The Forest Service has recognized the need to increase cultural resource funding in Region 3 (Arizona and New Mexico). Region 3 has been raised from 7 percent of the cultural resource funding in 1982 to 15 percent in 1988. The estimate for R-3 in 1988 is $1,855,000--up $103,000 from 1987.

The following table shows funding for cultural resource management, by Region.

Region	1982	1983	1984	1985	1986	1987	1988
			(Dollars in thousands)				
1	395	395	593	595	589	714	1,088
2	192	192	430	476	687	575	667
3	445	504	772	898	1,357	1,752	1,855
4	216	216	743	812	515	558	724
5	1,998	1,748	1,693	1,693	1,477	1,785	1,948
6	841	1,039	1,813	1,853	1,710	1,740	2,609
8	744	744	1,070	1,071	932	1,026	972
9	940	890	1,447	1,432	1,410	1,441	1,591
10	270	225	364	383	346	339	522
	6,041	5,953	8,925	9,213	9,023	9,930	11,976
Region 3 Percent of Total Cultural Resource Funding							
	7%	8%	9%	10%	15%	18%	15%

62. Question: Are Forest Service Cultural Resource Management areas appropriately designated? How many new areas were identified last year?

Answer: It is not in our management practice to designate "Cultural Resource Management Areas". We have a designation of Special Management Areas that includes areas of unique archaeological interest. Such areas have been designated when circumstances warrant. Our standard practice is to identify historic or prehistoric properties or sites, evaluate these properties for importance, nominate the most important ones to the National Register of Historic Places, and assure that all significant sites or properties are properly considered in the management plans for the Forest area in which they occur. Given this, we can say that cultural resource sites and properties are properly designated. We are however, trying to shorten the time between identification and evaluation, and increase the number of nominations to the National Register.

We identified 11,336 historic and prehistoric properties in 1.5 million acres of survey work in FY 1985. Of these, 2,123 were evaluated for their relative importance. As a result, 1,124 properties were determined to meet the criteria for listing in the National Register. In calendar year 1986, 53 properties were officially listed in the National Register of Historic Places.

I hear concern from my constituents that the Forest Service may designate an area a Cultural Resource Management Area but not follow though with the appropriate level of funding and management to adequately protect the area.

63. Question: What is the Forest Service doing (other than minimal legal compliance) to ensure the protection of Cultural Resource Management areas?

Answer: The majority of our appropriated funding is expended in project-related activities which are required under the National Historic Preservation Act. We recognize the importance of other management objectives and are actively engaged in efforts to protect, preserve, and interpret the resource in the public good. A National task force is working on recommendations for a varity of enhancement activities to increase the public awareness and knowledge of this resource. We are working with both the Department of Interior and the Society for American Archaeology on initiatives to foster the public concern for and protection of historic and archological properties. We continue to actively pursue those who willfully damage and destroy these resources through our law enforcement program, including training and investigative operations.

64. Question: What measures are being taken to interpret, develop, and protect these areas?

Answer: We spend a considerable amount of money on a variety of stabilization, interpretation, and development projects, many of which have received local, state and national recognition. We are pleased with the outstanding and innovative work that we have done to protect, interpret, and develop cultural resources in the public interest.

65. Question: Do you have any way of determining how many archaeological historical sites have been damaged due to Forest Service actions? What action is the Service taking to mitigate this damage?

Answer: We have no count of the number of sites damaged as a result of Forest Service actions. We are certain that the number is declining as a result of our implementation of cultural resource management considerations and as we learn to better integrate these considerations into other management practices. It is our objective to eliminate all inadvertent damage to these resources from Forest Service actions. We are preparing to implement a number of management improvements as a result of a nationwide review of our cultural resource management program, some of which are intended to further reduce, if not eliminate, the incidents of site damage.

When a report of damage to a site is received, it is our policy to investigate and determine the extent of damage and ways of preventing future reoccurrences. Where damage can be repaired or where the damage continues to threaten the resource, we will attempt stabilization actions. A formal damage assessment and reporting process has been implemented in the Southwestern Region and is being considered for national implementation. Although this will allow us to tabulate the amount of damage that occurs annually, our primary objective is to eliminate inadvertent damage altogether.

66. Question: Does the Forest Service have adequate curation practices for the artifacts they acquire? What is the budget for curation activities? Are reports prepared on these artifacts in a timely manner?

Answer: The Forest Service contracts for the majority of the work which results in the acquisition of artifacts requiring curation. These collections are kept for the Forest Service in a museum or institution under an agreement which includes security and adequate curation. The few artifacts that are kept by the Forest Service receive adequate, if minimal, curation controls.

We have no separate accounting for curation activities since it is such a minor activity in the Forest Service. Costs for curation and storage at a museum are usually part of the contract for the project and are not separately tabulated.

In most cases, reports are prepared in a timely manner. Penalties are applied for failure to adhere to contract conditions, including the timeliness of reporting of work performed.

67. Question: What is the law enforcement budget for cultural resources? I note from your budget that a large percentage of enforcement funds is going to drug interdiction efforts.

Answer: Information on the specific funding for law enforcement for cultural resources is not available. However, law enforcement for cultural resoures occurs as part of law enforcement connected with recreation activities. This averages about 3 percent of the recreation budget, including operation and maintenance of recreation facilities. For FY 1988, this would be about $2.8 million.

The amount of this directed specifically to cultural resource law enforcement varies by Region according to the extent of cultural resource activities and severity of the law enforcement problem.

QUESTIONS SUBMITTED BY
SENATOR HOWARD M. METZENBAUM

In its effort to resist spending L&WCF monies, it appears that the Forest Service is discouraging its Regional offices from land acquisition activities. For example, the Supervisor of the Wayne-Hoosier National Forest informed me in a letter that the current land acquisition program for the Wayne National Forest has been postponed. As a result, I understand that new criteria are being developed which will increase the acreage available for exchange by slackening the standards used for determining exchangable lands. The draft Wayne National Forest Plan identifies approximately 9,700 acres of Forest Service land as "additional lands available for exchange", some of which are centrally located within the land base of the forest and which are not in the traditional areas available for trade.

68. Question: In light of the above, could you please explain the Forest Service's current land adjustment policy, and specifically, the rationale behind offering for exchange these central parcels of land in the Wayne National Forest?

Answer: During these times of budget austerity we are relying primarily on land exchanges to meet land ownership adjustment needs. Lands suitable for exchange are to be identified in the land management planning process. The draft Wayne National Forest Plan has identified areas of scattered Federal lands where consolidation is highly unlikely. Individual tracts were carefully examined to determine if they should be retained in Federal ownership. Those lands determined not to meet retention criteria are identified for exchange. Some of these areas are located in the central part of the Forest.

QUESTIONS SUBMITTED BY
SENATOR DANIEL J. EVANS

Region 6 Timber Sale Program

The President's budget calls for a national timber sales program level of 11.1 billion board feet, which is 100 million board feet less than the timber sales program authorized in the FY 1987 Continuing Resolution. In Region 6, however, the Forest Service plans to decrease the timber sale program from 5.2 to 4.8 million board feet, a decrease of 400 million board feet.

69. Question: Could you provide an explanation for the decrease in the timber sale program level in Region 6, particularly in light of the statements made in the budget request that the Forest Service anticipates an increase in the market demand for lumber as a result of an increase in housing starts and the U.S./Canadian agreements to impose a 15 percent export tax on Canadian timber?

Answer: Region 6 currently has nearly 11 billion board feet of timber sales uncut, under contract. Even at last years near record harvest rate, more volume was sold in FY 1986 than harvested.

With more than 2 years harvest under contract it is important that the Forest Service regulate the program in R-6 to ensure the volume under contract remains manageable and within the imposed cap. This, plus the need to provide for historical program levels in other Regions, is why the proposed fy 1988 program in R-6 is 160 million board feet less than FY 1987.

70. Question: Could you also provide a breakdown of the type of timber that will be offered for sale in Region 6 in terms of new green sales, reoffered sales, default sales, and salvage sales?

Answer: Region 6 proposed volume offerred target is made up of the following types of timber sales:

New (green) sales	2,417 MMBF
Reoffer sales	2,000 MMBF
Salvage sales	423 MMBF
	4,840 MMBF

The level of resell of defaulted timber sales is unestimated at this time, and will not be available until June 1987.

The budget request again assumes that Congress will enact legislation to alter the basis on which revenues from timber sales are paid to counties from gross to a net basis.

71. Question: Could you provide your analysis of the impact of this proposal on counties in Washington State?

Answer: We are presently developing a data base that will be used to estimate by forest and State what the payments would be on a net receipt basis. This information should be available within about six weeks.

Recreation Fee Proposal

The President's budget assumes legislation will be enacted to permit the Forest Service to increase the number of areas where it can charge fees for recreational use.

72. Question: If this legislation is enacted by Congress, will it generate sufficient revenues to enable to Forest Service to keep campgrounds and picnic facilities open to the public that have been subject to closure in the past few years?

Answer: If the revenues are returned to the Agency as proposed without other offsets, we will be able to open a number of the facilities that have been closed in the past. In order to be efficient, we have permanently closed some small, isolated units that had light use. We would of course not open those. However, others that have been closed, but facilities retained, could be reopened.

73. Question: If the legislation is not enacted, do you anticipate having to close campgrounds again this summer?

Answer: Yes. Those that had been closed in the past would remain closed. Some additional campgrounds could be added to the closure, but we feel this would be few in number. We would operate some campgrounds for a shorter period of time. Rather than opening them for use in the Middle of May, we could postpone the opening a couple of weeks, depending on the specific circumstances on each Ranger District.

74. Question: I would also like to know the status of potential campground closures in Washington State this summer.

Answer: Of the 10 campgrounds closed last year for lack of funds, 9 will be reopened. No other changes in operating schedules are expected.

Columbia River Gorge

The President's budget includes a request to rescind $3 million appropriated for acquisition in the Columbia River Gorge in the 1987 Continuing Resolution.

75. Question: Assuming that Congress does not act to affirmatively accept this rescission request, what is the timetable for completing these acquisitions in the Columbia River Gorge?

Answer: The President's budget included a request to rescind the entire $4.65 million appropriated for acquisition in the Columbia River Gorge in the FY 1987 Continuing Resolution. If the rescission request is not acted on affirmatively by the Congress, we would expect to obligate the entire $4.65 million in FY 1987.

76. Question: What is the present status of the timberland exchanges proposed in the Columbia Gorge NSA, PL 99-663?

Answer: Several landowners have indicated an interest in pursuing land exchange proposals. A summary of those contacts are as follows:

Times Mirror Land and Timber Company lands within the Gates of the Gorge Special Management Area were added to an ongoing exchange.

Frank Lumber Company has formally applied for an exchange.

SOS Lumber Company has formally applied for an exchange.

Broughton Lumber Company has formally applied for an exchange.

Covenham Forest industries, Inc., has not yet formally applied, but is discussing an exchange.

Longview Fibre, Inc., has not yet formally applied for an exchange, but indicated an interest in adding to an ongoing exchange.

Lenske/Smith has made no formal application, but has expressed an interest in an exchange.

Larson is considering application for an exchange, but may prefer selling.

Vanport Manufacturing rejected the opportunity for an exchange and requested continuation of an earlier purchase action for a 35-acre parcel within the Special Management Area.

The status of negotiations with private landowners is being reported to the Senate Energy and Natural Resources Committee, the House Committee on Agriculture, and the House Committee on Interior and Insular Affairs.

77. Question: Could you also provide an outline of the anticipated budget to be allocated in 1987 and 1988 for the establishment of the Columbia River Gorge National Scenic Area headquarters and the development of interim guidelines?

Answer: The Forest Service is responsible for creating Interim Guidelines for the entire Scenic Area, for reviewing development proposals to determine if they are consistent with the Scenic Area Act and Interim Guidelines and for developing portions of the Land Management Plan for the four Special Management Areas in the Scenic Area. The anticipated FY 1987 and FY 1988 budgets for these activities are:

Administration	FY 1987 Allocation	FY 1988 Request
General Administration	$ 496,000	$ 368,000
Land and Water Conservation Fund	230,000	215,000
Exchange	90,000	306,000
Fire	48,000	99,300
Timber Management	59,000	119,200
Minerals	19,000	39,700
Recreation	193,000	397,200
Wildlife	48,000	99,300
Watershed	48,000	99,300
Roads	50,000	99,300
Trails	19,000	39,700
Subtotal, Administration	$1,300,000	$ 1,882,000
Special		
Roads		$ 200,000
L&WCF Land Acquisition	$4,650,000	0
TOTAL	$5,950,000	$ 2,082,000

Mount St. Helens

The President's budget states that the Forest Service intends to complete this year the land exchange involving 42,000 acres of privately-owned mineral rights inside the Monument. This exchange was called for in the legislation that created the National Monument in 1982.

78. Question: Could you outline what steps remain in this exchange and what is the present schedule of completion?

Answer: A target date of September 30, 1986 had been set for an agreement on the exchange proposal, to be followed by the exchange notice, negotiation to finalize the exchange packages, issuance of the Forest Service decision on the exchange, and issuance of patents by the BLM. The field work and appraisals were completed on schedule and offers were made to Weyerhaeuser and Burlington Northern on September 15, 1986. Both Companies declined the offers, due to disagreement over the valuation of the potential geothermal resources of the Company lands at Mount St. Helens. The Companies value the geothermal resources in excess of $80 million, while Forest Service appraisals indicate fair market values below $300,000. All parties have met several times to reconcile the geothermal value differences, including consideration of counterproposals, but all meetings have been unsuccessful. All parties are now assessing the available data and developing possible alternatives for resolving the exchange.

The Budget Request did not include the $9.915 million appropriated for road construction on the Mount St Helens National Monument. I understand that the Forest Service is proceeding with the project as originally scheduled and that the Forest Service will submit a supplemental appropriations request to cover costs incurred by the Forest Service.

79. Question: Could you provide a present schedule for completion of the construction of the Road 99 project and an outline of road construction projects that are presently planned for construction?

Answer: Two specific appropriated amounts have been designated for road projects in connection with Mount St. Helens National Volcanic Monument.

(1) $9.915 million from the Highway Trust Fund; and
(2) $8.473 million from the Forest Road Program.

(1) The Highway Trust Funds were originally designated for use at Mount St. Helens in the FY 1986 Continuing Resolution. However, "imperfect language" in the Resolution did not enable the transfer of funds to the Forest Service.

Corrected language in the FY 1987 Continuing Resolution provided contract authority, and a 1987 supplemental request has been submitted with the FY 1988 request to liquidate obligations incurred by the Forest Service.

The Funds will be used as follows:

Reconstruct major arterial which provides access to blast area and Windy Ridge Overlook. Contract was awarded February 12. This is the "99" road (16.4 miles). Expect completion in the summer of 1988.	$7,650,000
Contract Administration for "99" Road Contract.	$ 500,000
Preconstruction engineering for the "25" road. Another major arterial into the Monument area.	$ 500,000
Six to eight parking lots and visitor points within the Monument area.	$ 400,000
Construction of 6 local roads (8-9 miles) which enable safe travel to other recreation sites.	$ 685,000
Program Management.	$ 180,000
Total	$9,915,000

(2) In the FY 1987 Continuing Resolution, $8.473 million in Forest Road Program funds was appropriated to continue the road construction program within the Monument area.

Reconstruction of the second major arterial to access the blast area. This is the "25" road (11.4 miles). Contract to be let in August/ September 1987.	$4,660,000
Construction engineering on the "25" road.	$ 573,000

The following items will be accomplished by FHwA through a cooperative agreement:

Reconstruction of Muddy River Bridge. Contract to be let in late summer, 1987.	$1,035,000
Reconstruction of Eagle Cliff Bridge. Contract to be let in late summer, 1987.	$1,596,000
Reconstruction of Upper Pine Creek Bridge. Contract to be let in early summer, 1987.	$ 515,000
"99" road technical support.	$ 27,000
Bridge removal (2 temporary bridges used for timber removal will be removed and hauled to other sites for further use.)	$ 67,000
TOTAL	$8,473,000

The FY 1988 Forest Road Program contains approximately $300 thousand for Mount St. Helens local roads. Approximately $2.2 million of local road construction needs will be requested in future years.